Staff Findings
and Recommendations

Connecticut's Economic Competitiveness in Selected Areas

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Legislative Program Review
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CONNECTICUT GENERAL ASSEMBLY

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Introduction

The Legislative Program Review and Investigations Committee undertook this study in May 2009 to examine state laws, policies, and strategies to determine if they help or hinder the state's economic competitiveness both globally and with Connecticut's surrounding states. When the committee voted to approve this study the nation was in a deepening recession, and committee members wanted to ensure that Connecticut would be well-positioned to compete in the global market place once the recession ended.

The findings and recommendations contained in this report build on the information presented in the October 6, 2009, briefing report. That preliminary report presented a continuum of economic development models from older, conventional structures aimed at capital investments, to newer paradigms that promote innovation and entrepreneurship. The briefing report concluded that Connecticut's public economic development framework is built on an older model that directs public support, including financial assistance, to individual companies, with the state's economic development agencies acting as lenders. In that capacity, the agencies' roles are primarily administering specific incentive and assistance programs: reviewing applications for assistance; making individual determinations based on programs, guidelines, and criteria; negotiating with companies on incentive packages aimed at attracting a business to, or retaining it in, the state; and managing the "investment" portfolio.

Whether these financial incentive packages to individual companies create and/or retain jobs and at what cost, is an ongoing debate. Many of the programs do not track the number "actual" jobs created or retained, especially over the long-term. Even organizations like the Tax Foundation, that are certainly not considered anti-business, question the economic value of individually targeted state incentives.[1]

The new model of economic development instead focuses on long-term advancement of a state's assets including its human capital, through improving its education and training to create a pipeline of educated, productive workers, and enhancing the state's physical infrastructure, especially in areas of transportation and technological supports for the New Economy.[2] The model also envisions government providing broad-based technical assistance to businesses to increase their access to private capital, to streamline or adapt their processes to changing markets, and building collaborative networks among government, business, and educational institutions to implement this type of assistance and to promote innovation-based policies.

Even in good economic times, this would require establishing goals, setting priorities and longer-term and shorter-term policies and strategies. However, the current recession continues to threaten the state's economy, with more than 80,000 job losses, businesses closing, shrinking state revenues, declining personal income, all shaking the confidence of the state's residents. While most states' economies are incurring serious problems,[3] and even though Connecticut is not among the states cited as experiencing the most severe issues, this state did not have robust

[1] Tax Foundation, 2010 State Business Tax Climate Index, September 2009, Introduction, page 1.
[2] The "New Economy" is generally defined as one that is global, entrepreneurial, technology-focused, and knowledge-based.
[3] "*Beyond California: States in Fiscal Peril*," Pew Center for the States, October 2009.

job growth even before the current recession. Thus, in this recessionary period, state economic development policy must also focus on immediate ways that will help "turn the curve" on job losses, and begin to restore public confidence in the state's economy. There is a need to develop a multi-level strategy that creates jobs in the short term, ideally improving the state's broader infrastructure at the same time, and protecting and building on the state's assets for the long term.

Program review staff concludes that the state's economic conditions cannot be addressed in a "business as usual" fashion, and that a greater sense of urgency is needed to right the state's economy now and enhance its competitiveness into the future. This view that action is needed immediately was expressed repeatedly throughout the course of the study: in testimony at the committee's public hearing, in interviews with committee staff, and most recently at legislative forums convened by leaders to address jobs and competitiveness.

The state Department of Economic and Community Development (DECD) in September 2009 issued the state's first comprehensive economic strategic plan containing 66 recommendations in three broad areas – responsible growth, talent and technology, and cultivating the state's competitiveness. Unfortunately, the plan does not:

- establish any overarching goals for the state's economy;
- prioritize among the recommendations;
- indicate (except for a few recommendations), who or what agency is responsible for implementation, or what action or tasks are required;
- propose a time frame for implementation; or
- identify funding sources for many of the recommendations requiring financing.

The plan was primarily developed in better economic times, and many of the recommendations have price tags attached, no doubt compromising implementation in this current fiscal climate. While committee staff believes the plan does provide a compilation of ideas and strategies upon which the state can take action, without establishing plan priorities as the legislation required, there is no guidance for what should be acted upon first.

During the first week of December 2009, DECD announced that, at the direction of the governor, the department will hold four informational forums on the plan "to solicit further input from the public on the recommendations contained in the plan, priorities moving forward and ideas for implementation." The sessions will be held around the state, with the first one on December 8, 2009, and the other three slated for January 2010. It might have been more productive for the department to have established priorities and an implementation plan and then receive public input, but the informational forums at least indicate some initiative to move the plan along.

At the committee briefing meeting, staff indicated that it would examine the state economic strategic plan in greater detail and staff would also analyze the state's current economic development structure and strategies, and those contained in the plan, and compare those with a compilation of National Governors Association (NGA) best practice for promoting and growing the economy. The best practices table was presented in the briefing and is contained in Appendix A. The NGA best practices are organized around six broad strategies, each containing a series of action steps that states should pursue to grow and compete in the New Economy. Those six broad strategies are:

- Accelerate Innovation
- Develop a Comprehensive Innovation Policy
- Streamline Regulations and Develop Flexible, Responsive Government
- Create a Coherent, Market-Driven Trade and International Development System
- Convene Leaders From Various Sectors
- Improve Access to Seed and Venture Capital

Report organization. The report includes three sections. Committee staff adapted the NGA Best Practices to organize and present its findings and recommendations contained in Section I, on promoting and growing an innovative state economy. The section has several sub-categories, each beginning with one of the NGA best practices, followed by analysis and findings around Connecticut's current activities in that area, and whether and how the DECD economic strategic plan addresses the issue. Each sub-category also contains staff recommendations for strategies the state should adopt to implement the model practices NGA advocates.

The October 6 briefing report provided an innovation scorecard, benchmarking Connecticut's competitiveness in a number of areas, and comparing the state's performance to nine other states considered leaders in technology and innovation. At the briefing meeting, committee members asked staff to look at some of those states to determine what strategies they have in place to enhance competitiveness, and whether they might be implemented here. Staff examined economic competitiveness policies and strategies in four of those states – Massachusetts, Pennsylvania, North Carolina, and Virginia -- and refers to their efforts in several areas in Section I.

Section II examines Connecticut's tax credit policy, and analyzes and proposes modification to several of the business tax credits to enhance their relevance to the current economy and better achieve the purpose of tax credits in stimulating economic activity. Section III addresses the narrower scope of Connecticut's competitiveness with its neighboring states, especially in the area of alcohol sales, and specifically the issue of the state's ban of alcohol sales on Sunday.

Section I

Promoting and Growing the New Economy

As noted in the Introduction, this section is divided into several categories; each category starts with a National Governors Association (NGA) "best practice" and action steps (presented in a box) to promote and grow in the new, innovation-based economy. Each category in the section is followed by a discussion of what strategies exist in Connecticut, whether the economic strategic plan addresses the area, and committee staff findings and recommendations for that category.

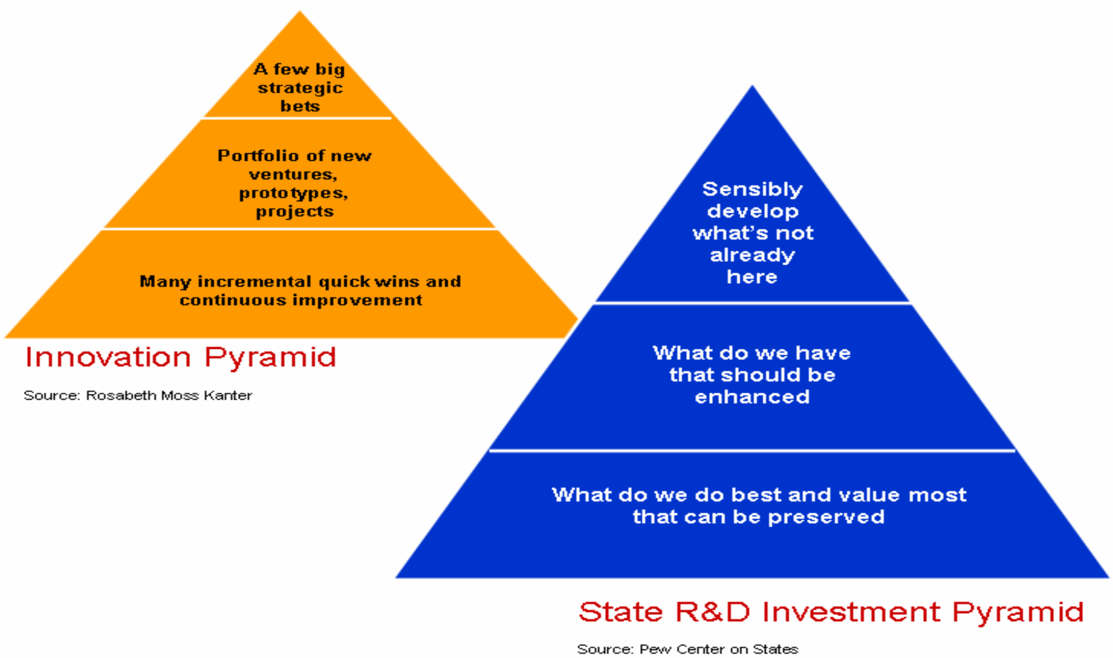
Accelerate Innovation

- ***Understand state's economic assets***
- ***Align policies with strengths and assets***
- ***Make strategic investments especially in human capital, research and development, and infrastructure***
- ***Communicate the importance of innovation in a state's economic development***

Program review staff finds that Connecticut follows the older model of economic development where state assistance is directed toward capital investments in large individual companies rather than on human capital, research and development and other foundations that bolster innovation and promote the New Economy. Contributing to that older model are the following factors: the state's organizational structure and programmatic approach to economic development; the state's lack of overarching economic goals; and budgeting by agency rather than strategic or program budgeting. This makes it difficult to determine if Connecticut has clearly stated what the state's economic assets are and whether policies and investments are aligned or not.

As the state's primary economic development agency, the Department of Economic and Community Development should take the lead in assessing and communicating the state's strengths and using an investment strategy that would guide the state's resources to preserving and nurturing those assets. A schematic of such an investment strategy, as the one developed by the Pew Center on the States, is shown on the right side of Figure I-1.

Figure I-1: Investment Pyramid



DECD should be the lead agency for policy and program development that support the New Economy, such as workforce competitiveness, job creation, and constructing a regulatory environment conducive to business. DECD should also articulate and convey the message that the competitiveness of the state's economy is key to producing revenues that support state services and thereby preserving the quality of life residents enjoy. While these overall economic development policy efforts must be coordinated with other agencies and stakeholders in the state, it is important that developing and preserving the economy receive as much attention and resources as other needs addressed by state government.

As cited in the briefing report, DECD has been involved in economic planning and policy development, but has been sporadic and not comprehensive in its approach. Agency staff was involved along with the Competiveness Council[4] in the development of three plans around competitiveness and the cluster strategy between 1998 and 2005. Also in 2005, DECD was also one of several agencies that was legislatively mandated (P.A. 05-165) to develop a plan by 2006 to establish an innovation network for economic development.

However, DECD's role in economic policy development and strategic planning has not been an agency priority. For most of the last two decades, the department has had several missions, with responsibilities for housing and community development as well, often competing for agency commitment and resources. Further, the legislature has mandated many economic development programs over the years, and often those have been assigned to DECD to administer. With agency operations geared to program administration – accepting and determining applications for assistance -- the department has developed a reactive culture that

[4] The Competitiveness Council was begun in 1996 as an informal group of more than 100 business leaders charged with looking at ways to improve Connecticut's business environment and how a full-fledged industry cluster initiative might work. The Council received official designation in December 1998, through Executive Order 13 issued by then-Governor Rowland.

responds to requests or legislative program mandates, but is not leading economic development for the state.

The plans developed with DECD involvement have addressed Connecticut's economic strengths, including its industry cluster initiative, and established priorities to support them and drive the overall economy, such as implementing training programs to strengthen the state's highly skilled workforce, capitalizing on the potential of the state's universities and colleges, and aggressively pursuing international trade.

Further, the 2006 Innovation Network plan clearly was an attempt to link innovation and economic development policy. A number of consultant reports[5] were used to help build the Innovation Network plan, identifying Connecticut's core technology strengths where the state holds a competitive advantage and where investments would produce the greatest dividends.

However, as the briefing report concluded, many of the initiatives proposed in those plans and others were never implemented, often due to funding issues, and while other programs were begun, they frequently were not sustained. This lack of implementation no doubt further frustrates those involved in economic development policy and planning, leading to a "why bother?" culture that is difficult to change once entrenched.

Another complicating factor in determining alignment of economic development investment and resources is that funding for innovation and technology support is dispersed through many different agencies and programs, therefore making it difficult to calculate a total dollar amount that supports the New Economy. Further, in this fiscal crisis, state financial support for many of these programs is being trimmed or cut altogether (e.g., the stem cell research fund is being taken in the latest governor's deficit mitigation plan). These measures not only will fail to accelerate innovation, but will stall its progress significantly.

The plans discussed above focused on segments of the state's economy, but no overall state economic strategic plan had ever been developed until recently. In 2007, the legislature mandated that DECD develop such a plan (P.A. 07-239). That legislation mandated a detailed process be undertaken to develop the plan, areas that it must consider, as well as a time frame for producing the plan. DECD followed the legislative mandates and the plan was issued in September of 2009.

Unfortunately, the plan is being introduced in the worst recession in a generation, and many of the recommendations have a price tag attached. As stated in the Introduction, the plan establishes no overarching goals for the state's economy, and establishes no priorities, and so does not provide policymakers a picture of what the state should focus on first, what might be achieved when, and at what cost. As committee staff was completing this report, DECD announced in early December 2009 that, upon the governor's direction, the department will hold four informational sessions on the plan over the next few weeks to help develop priorities and an implementation strategy. While committee staff believes it would have been more helpful for

[5] The two primary reports were: *Building Upon Connecticut's Core Competencies in the Knowledge Economy* (Batelle, April 2005) and *A Prospectus for Technology Transfer and Commercialization (*Innovations Associates, July 2005)

the department to have developed priorities and an implementation proposal first, and then gathered public reaction, it does demonstrate that the governor and department recognize a need to develop priorities in order for the plan to move forward. Therefore, program review staff recommends:

DECD, after holding its public informational sessions, should develop an action plan with priorities that should be achieved first, in a one-year time frame, and sets goals for a longer (five-year) period, and for those priorities established, propose what agencies or organizations will be responsible for accomplishing the tasks. The action plan with one-year priorities shall be developed by February 15, 2010.

Without clear direction or an agency taking the lead, it had appeared the plan was a static, one-time document that was a response to a legislative mandate, as opposed to a call to action. The December announcement on the informational sessions indicates that the plan is a "work in progress." The plan does acknowledge that many of the recommendations require input from various stakeholders and will also require legislative action; however, as the lead economic development agency this should not preclude the department from setting priorities both in the short and long term.

There are many examples of organizations and other states that have done this, including for example, Washington, Virginia, and North Carolina. Locally, the Metro Hartford Alliance (the chamber of commerce for the Hartford region) has established six strategic goals for 2008-2011, with its annual 2009 priorities in a one-page, easy to comprehend part of its report. Committee staff acknowledges that differences exist between a regional business organization's plan, and one for an entire state, but without a clear idea of what is most important and how it can be executed, none of the plan might be realized.

Program review staff makes recommendations later in this section that should create an organizational structure that is more flexible, responsive, and able to implement policies and strategies that communicate and promote the state's strengths, and makes other proposals that will more clearly target ways of accelerating innovation.

Cluster-Based Economic Development Strategies
• ***Convene leaders from various sectors to work with policymakers***   • ***Align investments, and build and promote skills and talents around a cluster-based economy***   • ***Appoint liaisons to work with clusters to understand economic challenges and opportunities***   • ***Work with other states in region to promote cluster activity and growth***

In addition to the best practices the National Governors Association has developed as a guide for states to use in building and promoting an innovation-based economy, the NGA has issued an entire report[6] that outlines a separate set of strategies designed to promote economic development around industry clusters. Not surprisingly, there is some overlap in the strategies recommended.

As reported in the briefing, Connecticut adopted the cluster initiative in 1998, and identified nine industry clusters that it has supported to varying degrees over the years. Those are:

- aerospace components manufacturing;
- agriculture;
- bioscience;
- insurance and financial services;
- maritime;
- metal manufacturing;
- plastics and plastic manufacturing;
- software and information technology; and
- tourism.

The briefing report summarized the economic profile of seven clusters between 2005 and 2008 (prior to the recession). (Agriculture and tourism each have support from another designated state agency, and thus were not part of the study scope). All the clusters saw employees' average wages increase in current dollars. Three – aerospace, technology, and insurance and financial services -- saw improvement in wages and in the number of both employers and employees. Two of the clusters – maritime and bioscience -- saw positive trends in wages and the number of employers, but a decrease in employees.

The committee staff finds that DECD had, until fairly recently, actively supported the clusters. Those efforts included:

[6] *Cluster-based Strategies for Growing State Economies*, National Governors Association and the Council on Competitiveness, 2006.

- creation of the Competitiveness Council to advise on cluster development and ensure responsiveness of government agencies on cluster implementation;
- three competitiveness plans jointly developed by DECD and the Council;
- substantial financial support from the department's budget to the clusters earlier in the decade ($2.4 million in FY 02); and
- promotion of both individual clusters and also cross-cluster activities -- such as increasing productivity in manufacturing, support of the business incubator network, the procurement technology assistance program – with most of these supported through DECD funding to partner agencies.

Program review staff finds that more recently state support for industry clusters has weakened. For example:

- the Competitiveness Council was terminated through Executive Order 24, in February 2009, as an effort to eliminate non-statutory boards and commissions, and nothing was established in its place;
- committee staff review of DECD annual reports from FY 05 through FY 08 determined fewer staff activities around industry clusters more recently, especially in FY 08;
- interviews with industry cluster representatives indicate tepid DECD support for cluster initiatives;
- DECD funding for clusters was $40,000 in FY 04 – down from $2.4 million in FY 02 – and since FY 04 the department has provided no funding for clusters;
- few DECD staff resources are dedicated to the cluster initiative -- one person is assigned to the insurance and financial services cluster; one person had been assigned to the bioscience cluster, but the post-retirement DECD organization chart shows that office no longer exists, merged into the business development division;
- the recently issued economic strategic plan contains no recommendation around supporting the cluster initiative; and
- there has been no tracking or reporting on industry clusters by DECD (or others) in many years.

Program review staff finds that the economic development literature supports the industry cluster initiative as one that works. Clusters have shown "that they can power a regional economy by boosting innovation, wages, employment opportunities, entrepreneurship, and business diversification."[7] All four states that committee staff used for comparison -- Pennsylvania, Massachusetts, Virginia, and North Carolina -- actively promote the industry cluster strategy.

Further, a recent publication of the Federal Reserve Bank of Boston advocates for more cross-state support for cluster activity that may cross state borders, as a way of improving the region's competitiveness. "Historically, U.S. cluster initiatives have been conducted with support from an economic development agency at a level no higher than a state. But in the current

[7] *Cluster-Based Strategies for Growing State Economies,* National Governors Association, 2006, page 3.

economy, states must consider the potential of multi-state efforts and try to identify cross-border opportunities."[8] The report also states that "although it may seem daunting to try and coordinate efforts with competitive neighboring states, a super-regional approach would likely be a capital magnet for federal programs and, over time, should make a region more competitive in the global economy."

Program review staff believes that DECD has allowed the cluster initiative to languish due to lack of attention and support, and has not developed an alternative strategy for the cluster initiative. Committee staff concludes that the cluster strategy is one that the literature and experience has shown can bolster competitiveness, and should be strongly pursued.

Therefore, program review staff recommends that the industry cluster initiative be revived as a state economic development strategy in the following ways:

Reinstate the Competitiveness Council with some modifications. Rather than being a creation solely of the executive branch, it should be a statutorily established entity with appointments by both executive and legislative branches. It should be composed of 18 members, with nine appointments made by the governor and nine by legislative leaders of both majority and minority parties. Appointments should be made of business leaders from various industry clusters and from various geographic areas of the state. Council meetings should be held at least quarterly. The commissioners of DECD, Labor, Transportation and Higher Education, and the Executive Director of the Office of Workforce Competitiveness should be ex officio members of the Council. Staffing for the council's work should primarily be from the Department of Economic and Community Development, but supported collaboratively with any staff of the individual cluster organizations.

The primary role of the Competitiveness Council should be to guide public policy decisions and investment strategies that best promote competitiveness of the state's economic drivers, including its industry clusters. The Council's role should also ensure that policies around the cluster initiative are being implemented by relevant state agencies, including collaborative efforts with partner agencies, both public and private.

DECD should designate a Cluster Initiative Team within its Business Development Division that would be responsible for strategies that cut across industry cluster areas. It should be staffed by three to four of the economic development specialists currently employed in the Business Development Division (including the two already assigned to insurance and financial services, and bioscience.) These staff should be proactive in working with clusters, determine what strategies work, what obstacles the clusters face, and coordinate with other state agencies, as well as state-level and regional

[8] *A Stronger New England through Industry Clusters,* Federal Reserve Bank of Boston, Fall 2009, pp 4-5.

economic development partner agencies to implement positive strategies and overcome problems.

- **The Cluster Initiative Team staff can serve as a conduit from the cluster communities to the Commissioner of DECD, who as a member of the Governor's cabinet, should lead in shaping policies to promote competitiveness, including those policies that may require an interstate, regional approach to promoting clusters.**

- **The Cluster Initiative Team should also work with clusters to initiate grant applications for federal funding such as the Economic Development Administration grants. (see below) Other duties of the Cluster Initiative Team should be to: attend cluster-sponsored informational sessions; provide information and technical assistance; and sponsor or coordinate events that would attempt to link businesses with opportunities.**

Rationale. Program review staff believes that the restoration of a leadership/oversight group is a critical step in implementing the NGA best practice *to convene leaders*. The Competitiveness Council had performed a crucial role in developing the state's three competitiveness plans, and its termination will create a vacuum in direct business involvement in setting the state's economic priorities. The recommendation that the Competitiveness Council be an entity of both the executive and legislative branches is one that the Council itself proposed in its 2004 plan, citing that the change would help the initiative fully achieve its potential impact at improving competitiveness and increasing prosperity. Further, committee staff believes that requiring the council to be established in statute offers greater assurances that the body will not be terminated, and that its work is recognized and valued.

When the industry clusters were first created, the Competitiveness Council was a very large group, with numerous businesses of each of the clusters represented. This committee staff recommendation proposes establishing the Competitiveness Council as a leadership and oversight body of the cluster initiative which requires the council to be a more manageable size as outlined in the *National Governors Association Report on Cluster-Based Strategies.*

While size and industry representation are important, program review staff believes it is also important that these business leaders represent various geographic locations of the state, as some industry clusters may well be concentrated in different areas and have different concerns. For example, while the current insurance and financial services cluster focuses on this activity in the Hartford area, additional state attention should be given to the financial services industry, including hedge fund activity, in the Fairfield County region. The lack of incubation facilities in Fairfield County, and that region's need for development of programs in entrepreneurship, perhaps through the University of Connecticut at Stamford, might also be areas that could be addressed.

PRI staff conducted interviews with business group leaders in various parts of the state, and heard that they think policymakers and agency staff in Hartford are unaware of or unconcerned about issues they face. It is therefore important that the business leaders convened represent different regions of the state as they would have first-hand knowledge of the gaps or obstacles that might prevent an industry cluster from optimizing its full economic potential.

The recommendation around staff organization would establish the cluster liaison activity envisioned in the National Governors Association report and should help ensure that the cluster initiative receives the state sanction and support it needs to thrive. Further, states that are considered models in economic development organize around business areas. For example, Virginia's Economic Development Partnership, a state quasi-public agency, has several business development teams, including one for advanced manufacturing and another for science and research, each made up of three to four people. While PRI staff recognizes DECD does not have the number of staff to dedicate to individual business areas or clusters, dedicating at least three to four people on cross-cluster initiatives would be a positive step.

Regional Cooperation

Connecticut's economic development agencies have not been leaders in working with other states or regions in promoting this area's competitiveness. A primary example of lack of leadership is with the Hartford-Springfield economic partnership (HSEP). The partnership was formed in 2000 with the public announcement of both Massachusetts and Connecticut governors at the time, and its purpose is to increase the cooperative efforts to market the region along the I-91/Connecticut River Valley between Hartford and Springfield. The organization has branded the area "The New England Knowledge Corridor" and cites that the region is home to:

- 1.86 million people;
- a labor force of more than 1.1 million;
- 41,000 companies; and
- 32 universities and colleges with over 120,000 students.

The partnership is overseen by a steering committee of more than 20 representatives of business organizations, planning agencies, utilities, and public and private higher education institutions. While Connecticut's universities and colleges, as well as members of the management team from Bradley International Airport, are represented, not one of the state's primary economic development agencies is a member of the steering committee. The absence of state economic development policymakers on such a regional initiative provides yet another example of the lack of a visible, proactive presence in leading and supporting efforts to promote state and regional competitiveness.

The state economic development agencies have also been absent in assisting with implementing another of Harford-Springfield partnership's primary initiatives. A report released in 2004, co-sponsored by members of the partnership with BEACON[9], highlighted the area as a

[9] "The Medical Device Industry in Southern New England's I-91 Corridor," Biomedical Engineering Alliance and Consortium, the organization that promotes the medical device industry. The 2004 report was co-sponsored by

potential primary medical device cluster. The 2004 report noted that the corridor already encompassed 18 percent of New England's total medical device manufacturing employment, and supported 31 percent of the contract manufacturers registered with the federal Food and Drug Administration (FDA). Additional competitive advantages of the region include: skilled labor, access to northeast markets, higher education and research infrastructure, and high quality of life. Further, the region's economy has a long history of precision manufacturing, with processes similar to those required to meet FDA standards. Thus, the report indicates impressive current strength of the industry and cites that the industry has great potential to grow.

However, the report results have not gotten much support or traction from the state Department of Economic and Community Development. While not an official sponsor of the study, the state's lead economic development agency might have taken a more proactive role in developing the cluster potential identified in the report. For example, it might have worked with CONNSTEP[10] to understand which manufacturers already produce medical devices, which ones show immediate potential of transferring with or without assistance from CONNSTEP, and perhaps assisted with studies on potential demand for medical device products, here and abroad.

DECD also might have worked with some of the partner agencies that sponsored the study to investigate what obstacles this industry might face – e.g., identifying potential new products, locating experts to educate potential manufacturers on the FDA-approval process, or marketing the ready transportation available at Bradley International Airport. DECD might also have publicly declared state support for the industry, and offered agency assistance to promote it. An opportunity to do that was at a recent symposium sponsored by BEACON and Pfizer, and held at Northeast Utilities, entitled *Forecast for the Next Decade in the Medical Device Industry.* However, the state's economic development agency was not among the presenters.

DECD, in the state's economic strategic plan, recommends that the state enter into a "knowledge corridor" agreement with Massachusetts to promote the development of biomedical devices along Interstate 91. The plan states the Knowledge Corridor will dovetail with the agreement the two states have for the New Haven to Springfield high-speed rail corridor. However, no action steps or time-frame for this are given in the plan. Therefore, program review staff recommends:

DECD should act as the lead agency and proceed with the steps needed to execute the knowledge corridor agreement (Springfield/Harford) by July 1, 2010. Once the agreement is in place, DECD should publicize the state's commitment to the industry development, and work with BEACON and the Hartford-Springfield Economic Partnership on implementation.

Other opportunities exist for regional economic development action. In early 2009, the Hartford-Springfield Economic Partnership, in partnership with the Connecticut Business and Industry Association, conducted a survey of businesses in the partnership region – Hartford,

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utility companies in the two states, as well as two Massachusetts regional economic development councils and the Metro Hartford Alliance.

[10] Connecticut State Technology Extension Program, a federal/state partnership that helps manufacturers reengineer their processes.

Middlesex, and Tolland counties in Connecticut, and Hampden, Hampshire, and Franklin counties in Massachusetts. Almost 700 businesses responded, across many business areas, and the results were recently issued.[11] The survey sums up that, given the difficult economy, fewer than half of the respondents said they had plans to expand in the next two years, but only 15 percent planned to take actions that would have a direct negative impact on the region: almost none (4 percent) planned to relocate out of the region; shut down (2 percent); and only 9 percent plan to sell their business within the next five years. Thus, the vast majority of respondents expect to stay in business, and to remain in the Hartford-Springfield region.

Some of the benefits of the region cited by business survey respondents include the top-notch educational institutions, and proximity to key markets, along with the relatively affordable cost of living (compared to New York City and Boston). The survey indicates that understanding those advantages as well as the challenges of doing business in Hartford-Springfield is critical to ensuring the region's economic recovery and growth. This survey (and its results) is perhaps the most recent example, but there are other surveys and assessments of the regional and state business climate that DECD could use to focus its business development activities. Therefore, program review staff recommends that:

- **DECD should become an active participant on the Hartford-Springfield Economic Partnership steering committee; and**
- **DECD should use the results of the 2009 HSEP survey to focus its business development activities, especially building on the strengths of the region – educational institutions, relatively affordable cost of living, and proximity to key markets – to promote business expansion in the area.**

The department should work with its Connecticut and Western Massachusetts economic development partners to help diminish the obstacles businesses in the region face with a goal of helping business to expand. Forty-four percent of respondents stated they had plans to expand their businesses some time over the next two years; that is a sizable portion given the economy. The economic development agencies in the region should work collaboratively to make sure that expansion happens.

One specific action recommended by the National Governors Association to spur a region's economy is the creation of a large regional investment fund. Program review staff believes that establishing such a fund in this economic climate may not be realistic, but that state economic development agencies should collaborate with other state and regional agencies on actions that may not require investments. Further, where funding is needed, a coordinated, regional approach may produce better results -- improving chances of obtaining federal grants, and leveraging limited public funds with those from non-profit organizations, and for-profit companies – and tend to have greater impact.

[11] Hartford-Springfield Regional Business Survey, 2009.

<u>Flexible and Responsive Government</u>

- ***Streamline regulations to ensure state regulatory policy is flexible and responsive***
- ***Ensure the regulatory process is timely and not administratively burdensome***
- ***Provide guidance and assistance to small business and start-up companies***
- ***Seek innovative ways to provide assistance and leverage funding***

As concluded in the briefing report, the organizational structure of the state's economic development agencies is geared to an outdated economic development model. That model targets providing incentives to individual companies to relocate or remain in Connecticut, often when they threaten to leave. Further, the assistance efforts provided in the three separate agencies – Department of Economic and Community Development, Connecticut Development Authority, and Connecticut Innovations, Inc. -- are duplicative, cumbersome, confusing, and an inefficient use of staff resources.

Financial assistance. All three state economic development agencies – Department of Economic and Community Development, the Connecticut Development Authority and Connecticut Innovations, Inc. -- offer some form of financial assistance to businesses, as noted in the briefing report. For CDA and CII, this is their primary role; for DECD, while not the primary role, managing its business portfolio, with its job auditing and reporting requirements, can consume much of the agency's business development resources.

These three agencies provide state-sponsored assistance, but there are also other government and non-profit organizations that operate economic development financial assistance programs in Connecticut. The October 6 briefing report also presented information on the assistance provided by the federal Small Business Administration.

Since the briefing, program review staff has obtained information on the regional revolving loan funds that also serve businesses in towns and regions around Connecticut. (See Appendix B for summary of activity). Businesses' need for loans and other financing is certainly an economic development activity that state government must address, especially in times when access to private capital becomes tight. However, program review staff does not believe that all state economic development agencies should be involved in these programs, especially when other types of assistance to businesses are not addressed, often because of resources.

Loan activity. Program review staff examined the overall loan activity of DECD from 1992 through 2008, and found that the annual average number of loans was fewer than six a year. Even the Connecticut Development Authority, a quasi-public lending agency whose main mission is financing has made fewer than 40 loans per year over the past three years. Table I-1 below shows the total amounts of the assistance to business provided by each of the three economic development agencies over different time periods, along with the annual average amounts.

Table I-1. Assistance Provided by State Economic Development Agencies					
Agency	**Time Period**	**Total Number of projects**	**Avg. Annual # of Projects**	**Total Amount**	**Average Annual**
DECD	FY 92 – FY 08	100 loans 10 grants	5.6 0.5	$147 million – loans $20 million – grants	$8.6 million $1.2 million
CDA	FY 06 – FY 08	113	38	$71,357,941*	$23.8
CII	FY 00 – FY 08	N/A	N/A	$95,544,000 (mostly grants)	$10.5
*CDA assistance includes sales and use tax exemptions, accounting for more than half of the assistance Source: DECD, CDA and CII reports					

DECD and CDA appear to fund similar types of businesses, although CDA has its URBANK program to assist small business, while DECD has no direct financial assistance for small businesses. CDA and DECD have some of the same large companies in their individual portfolios. Both agencies use similar loan underwriting guidelines or due diligence criteria, and both must report on the jobs created and retained.

Operating expenses. As mentioned above, the Connecticut Development Authority's main mission is to provide direct lending and other financial assistance products to businesses, non-profits and others. Its loan products are displayed on its website (and were summarized in the October 6 briefing report) and CDA staff performs lending and portfolio management activities routinely. CDA currently has 26 staff, and its operating expenditures are about $6 million a year -- accounting for between 20 percent to 33 percent of its annual loan activity.

Since 2000, the operating expenses for Connecticut Innovations Incorporated totaled $4 to $5 million a year. While the amounts have been relatively stable from year to year, those expenses translate to more than 100 percent of CII's overall funding amounts in some years. Committee staff recognizes that CII staff performs activities in addition to financing and portfolio management, such as running the BioBus education program, a technology competition called Yankee Ingenuity, and scholarship programs, but there has to be a less expensive way to provide both.

There is no way to precisely calculate what DECD's operational expenses are as a percent of loan and grant activity, but, even excluding that agency's expenses, an average of $10 million to operate the two quasi-publics on annual loan (or grant) activity of $40 million is high. The Connecticut Development Authority and Connecticut Innovations, Incorporated are self-sustaining, in that the staff and operations are paid for with loan repayments, investment returns, and fees, rather than General Fund or bonding funds. However, if operational expenses can be trimmed, that may mean more funding could be provided for loans or grants to businesses, especially for start-ups and technology-based businesses.

Program review staff believes it can also be confusing to businesses about where to seek financial assistance. Staff believes that each agency was necessary when financial incentives were the main framework of economic development, with each intended to deliver a certain type of financial incentive program or programs. However, newer structures support co-location, collaboration and multi-service entities where businesses may receive assistance at one place. It is quite possible that companies that might not be good candidates for CDA loan products might be better-suited for CII assistance and vice versa; businesses should not have to go to two separate locations.

Further, the direction of more current economic development strategies has changed from one of providing direct financial assistance to individual companies or projects to broader support across businesses. The proposal below would allow DECD to focus its resources on providing that broad support. To address these organizational issues, and better align the state's economic development approach to the new model program review staff recommends:

> **The Connecticut Development Authority and Connecticut Innovations, Inc. shall be consolidated, and all direct business financial assistance programs shall be transferred from the Department of Economic and Community Development to the combined authority. To ensure that the practice of financing innovation occurs, half of all annual state business development assistance should support innovation- and technology-based businesses, and start-ups.**

Rationale. First, the recommendation will create an organization structure better suited to implement a newer model of economic development. Further, the merger concept has the support of the executive branch. The consolidation of CII and CDA was proposed in a bill during the 2009 legislative session, implementing economic development areas of the governor's budget. The bill was supported by the heads of DECD, CDA, and CII in public hearing testimony but, while some of the other proposals in the bill did pass, this merger did not.

While no savings from staffing reductions would result from this recommendation immediately, program review staff believes that future saving should result as vacancies occur, especially those in executive, managerial, administrative, and marketing areas of the quasi-publics. More immediate savings should occur in general and administrative expenses if CDA and CII are co-located, through reduction in rent, utilities, and contracting expenses for auditing and the like. The general and administrative expenses for CII in 2009 totaled $1.724 million; a $1 million savings is not unrealistic.

Responsibility for administration of tax credits currently within DECD would remain. That agency has experience with the credits, and program review staff believes this makes a clear and natural distinction between responsibilities of the two agencies – direct financial assistance would be under the purview of the combined quasi-public and tax credits handled by the state agency – and one that would be much easier to communicate to all businesses.

Regulatory Environment

A state's regulatory environment is an area often linked to whether a state is competitive or not. In many cases, the environment is based more on process and perception, than on numbers or other objective measures, and is therefore difficult to assess on any state comparison, benchmarking, or scorecard.

A couple of organizations that rank states on their business climate use proxies to gauge states' regulatory environments. Forbes measures it by examining regulatory and tort climate, and by that measure Connecticut's rank has worsened from 28th in 2006 to 35th in 2009. The Beacon Hill Institute, which issues an annual report on states' competitiveness, uses a measure of government and fiscal policy to gauge regulatory environment. Using that measure, Connecticut has been below 40th each year since 2004.

While certainly a subjective measure, the "business friendly" environment is widely used in marketing strategies by states like Virginia, with a Number 1 ranking by Forbes and others, and is certainly an aspect that may tip a decision for a business to locate or expand in a given state. Being considered not "business friendly" can present a handicap for a state marketing campaign, especially when it is a perceptual and subjective claim that cannot be easily refuted by numbers.

Perhaps of even greater concern than attracting new business is the impact the state's regulatory environment can have on companies currently doing business in the state, hampering productivity and increasing costs. However, despite the state's regulatory environment repeatedly cited as a major obstacle, the just-issued economic strategic plan barely addresses compliance with government regulations and whether that stymies economic development and job growth. The plan also does not address what aspects of the government regulatory process are burdensome – e.g., transportation permitting, environmental permitting, tax compliance -- or indicate that DECD will examine where bottlenecks occur. Instead the plan makes recommendations for creating a blue ribbon commission to examine the state's tax structure, (which has been done for the legislature in 2005) and study existing tax credits (which DECD could do).

The plan does recognize a need for more state agency integration and calls for a Workforce and Education Cabinet, composed of the heads of commissioners or designees of all state economic development and education agencies, as well as the chairs of the boards of governors at higher education institutions, the labor department, and the Offices of Policy and Management and Workforce Competitiveness. The cabinet would conduct economic and workforce analysis to align occupational supply and demand and develop educational programs to respond. That recommendation envisions a new "team" approach that would focus on policy and program integration through communication and information sharing, rather than on agency consolidation or major government restructuring. However, nothing similar is recommended for regulatory, permitting, or licensing areas that might more directly affect business.

This coordinated cabinet approach is similar to the one envisioned with the interagency steering council in the state's responsible growth efforts, and created as part of Executive Order 15 in 2007. That council is composed primarily of the state's development and regulatory agencies – the Office of Policy and Management, the Departments of Economic and Community Development, Environmental Protection, Public Health, Agriculture, and Transportation, and the state's housing and finance authority, and the development authority. The mission was to coordinate state policy development and capital planning to initiate and support efforts that revitalize cities, preserve the unique character of the state, and build livable, economically strong communities while protecting (the state's) natural resources. However, that effort has not been sustained, and the steering committee has not met since the beginning of 2009.

Informally, some progress is being made in streamlining the regulatory process in certain areas. In late October 2009, DECD and DEP issued a joint agreement effectively removing the need for DECD to apply for an exemption under DEP's floodplain management statutes, which had impacted the remediation of brownfields and redevelopment of certain properties. The agreement also includes other reforms that expand allowable activities under the flood management general permit – for example, dredging and structural rehabilitation of residential building will be exempt from the floodplain certification process. As the agreement indicates, this should assure a greater degree of certainty and predictability about the process to those involved in brownfield redevelopment and financing.

Program review staff believes the joint agreement is a positive step in creating an improved regulatory environment, but believes the issue is important enough to warrant a stronger, more urgent approach, and therefore recommends:

> **Creating a new state regulatory environment should be an executive branch priority, and one the governor should publicly announce. The administration should require that the interagency steering council resume its activity, stress that coordinating state policy and streamlining regulations impacting economic development is imperative, and inform the commissioners and other agency heads who are members of the council that its coordinating activities are as important as each agency's individual operations. The administration should use the DEP/DECD agreement as an example of interagency coordination and establish some measures of performance accountability.**

While committee staff does not include specific performance measures as part of the recommendation, they could include activity measures, like the number of interagency agreements that improve regulatory coordination and outcome or results-based measures such as improvement in Connecticut's ranking in national assessments of regulatory environment to business, or increase in state economic growth.

Provision of electronic services. Connecticut lags in providing services electronically to businesses or individuals. The Center for Digital Government (CDG), a national research institute on informational technology policies and best practices in state and local government, periodically ranks states that use digital technology to streamline operations and offer better service to citizens. In 2008, Connecticut ranked 37 of the 50 states. In isolated areas, like electronic tax filing, Connecticut performs well, but other areas of automation and electronic services must be provided.

One of Connecticut's regional planning agencies, the Capital Region Council of Governments, received funds in 2008 to develop an online permitting system that allows contractors and residents in member towns to create permits, request inspections, and track projects through the review, approval and construction phase and automate contractor license verification – all on one central website. There are many examples of other states that have used automation to improve and advance economic development. Virginia, which ranks third in the CDG assessment, offers the consumer the ability to conduct an interactive comparison of any state with Virginia on a whole series of measures important to business. New Hampshire's automated systems (discussed later in the report) allow a company to develop a business plan for exporting by electronically completing an interactive questionnaire on the state's international trade center's website.

The interagency steering council should also address ways that state agencies could electronically improve or expand services to customers, prioritizing those that impact business and economic development. The state Department of Information Technology shall assist in implementing these areas identified.

Other regulatory areas. Program review staff believes that it is not completely clear where regulatory bottlenecks occur, and even with better interagency coordination and expansion of electronic services, problems may still remain. Further, responsibility for correcting and improving the state's regulatory environment should not rest solely with the executive branch. During the scope development stage of this study the committee had discusses examining regulatory compliance and its impact on competitiveness as part of the review. However, given the limited staff resources and the already broad scope of the study, it was determined that the regulatory aspect should be examined separately. Therefore, program review staff recommends:

Connecticut business regulations and regulatory compliance be placed on the program review committee's study topic agenda for 2010.

High-cost areas. Other factors contribute to the state's high costs of business. (See Appendix C for a current assessment of cost contributors.) A cost that chokes the state's competitiveness is the price of energy. Connecticut's cost for electricity is the highest in the continental U.S., and two-thirds higher than the national average. At the legislative leaders' Job Growth Roundtable held in November 2009, energy costs were cited as the greatest cost differential of doing business in Connecticut. Further, energy costs impact most areas of the state's economy, not just manufacturing, as might be assumed. For example, computer use in the financial and insurance services industry consumes a great deal of energy. While many businesses have taken advantage of the state's energy efficiency fund to conserve energy and reduce consumption, those actions address only the demand side, and not energy supply and its costs.

The state's economic strategic plan makes 10 specific recommendations dealing with energy, from narrow ones such as expanding Connecticut's fuel cell bus fleet, to very broad ones including adopting a statewide green building code and requiring the state to prepare a biennial state energy plan with short-term and long-term goals. However, the plan does not discuss how these should be implemented. Further, despite the scope of the energy problem and its economic development impact, DECD does not sit on the Connecticut Energy Advisory Board (CEAB) nor on the Energy Conservation Management Board (ECMB), both of which make energy policy and program decisions, and both of which have a number of state agency heads as members.

> **To ensure that the state's energy policies are addressed as they impact the state's economic development, the commissioner of economic development, or a high-level agency designee, shall be a member of the Connecticut Energy Advisory Board and the Energy Conservation Management Board.**

Another NGA best practice that a flexible and responsive government should perform to accelerate economic growth is to assist small business. Based on economic activity over the past three decades, indications are that most future job growth will come from small business. However, program review staff believes not enough is being done at DECD to assist those businesses.

Connecticut contracts with the Connecticut Economic Resource Center to operate the Business Resource Center (BRC), which serves as first point of entry for most businesses seeking information and guidance. The BRC, which receives the majority of its funding from utility companies, provides a variety of informational services to businesses or potential businesses wishing to start up, expand, or locate in Connecticut. Table I-2 below shows the numbers of calls and assistance given at the BRC for 2009.

Table I-2. Business Resource Center: January 1 –October 31, 2009

Type of Assistance	Activity
Businesses Assisted at Time of Call	5,245 calls
Businesses Assisted with Follow-up Information Package	2,756
Businesses Referred to DECD	89
Source: CERC Business Response Center	

The Business Resource Center indicates that it follows up with businesses to gauge their satisfaction with services. While no satisfaction results are formally published, BRC states that based on the responses it receives from business, the vast majority are very satisfied with the BRC services. Companies referred to DECD are most often seeking some financial assistance or other incentive, and BRC anticipates they need more involved interaction. The Business Resource Center indicates it does try to follow-up on the inquiries forwarded to DECD to determine results, but DECD actions can vary complicating satisfaction reporting.[12]

Program review staff requested that DECD provide information on the 89 referrals that it received from the Business Resource Center (BRC). While DECD was not able to specifically identify the referrals from BRC, the department provided information on the 146 referrals it

[12] DECD actions can vary -- an application for assistance might be sent to the business and perhaps not returned; the business may have received some financial assistance (or not); or perhaps the case is still open, and negotiations on assistance continue – thus timing and outcome can impact results.

received for the period from July 1 through October 31, 2009. The results are presented in Table below.

Table I-3 DECD Inquiry and Referral Activity July 1 – October 30, 2009	
Overall DECD received **146** Inquiries or Referrals	
Internal DECD = **92**	External referrals = **54**
68 received "technical assistance" including letters about DECD programs, or general answers to questions	4 to CT Development Authority
15 were sent "pre-applications" – of those, 4 were sent back, 3 remain under review, 1 was sent a Letter of interest, and 11 not returned to date	5 to Connecticut Innovation Incorporated
3 Job Creation Tax credit – 1 approved, 2 not returned	1 to CT Center for Advanced Technology
4 Enterprise Zone inquiries – no applications	3 to regional revolving loan funds
1 Small Business Credit Assistance Program	5 to other state agencies
1 request for information	1 to Procurement Technical Assistance Program
	1 to SCORE
	3 to Small Business Development Center
	14 to Small Business Administration
	15 to Community Economic Development Fund
	2 to Connecticut Community Investment Corporation (CTCIC)
Source: Department of Economic and Community Development	

Program review staff finds the results of the table indicate that DECD is not an agency that is proactive. With one-third of the inquiries being sent to outside agencies, and another 46 percent provided a department informational response, it appears DECD's business development is little more than a referral function. In many ways the DECD functions duplicate those of the business response center at the Connecticut Economic Resource Center.

Further, DECD's internal organizational structure and functions are not aligned to meet its overall mission of business development. This is especially true in tight economic times when the agency can no longer rely on traditional financial incentives to attract or retain businesses. Currently, DECD's business development division is organized vertically, headed by an administrator and an assistant administrator, and staffed with nine economic and community development specialists, and one clerical position (three other specialist positions are vacant). In addition, the film office – staffed by a director and three associates -- was recently transferred to DECD from the Office of Culture and Tourism. This unit manages the film tax credit program the state initiated in 2006.

The job description for the economic and community development specialist, the most common position in the division, requires "considerable knowledge, skills, and ability, including knowledge of industry practices, markets and location issues, and skills in planning, organizing, and negotiating economic and community development activities." The position requires six years of experience or a combination of education and experience equal to six years, and the compensation level for the bottom level of the class is $64,500 (not including benefits). Program review staff believes that given the experience, skills and competency requirements, and compensation level, the business development staff should be much more proactive and handson in assisting business. To execute a responsive business assistance approach within DECD, program review staff recommends the following.

> **First, DECD should establish a team approach to business development, with three teams each staffed with 3 or 4 people. The teams would be responsible for: 1) clusters including cross-cluster initiatives (see previous recommendation on page 11); 2) incentive programs to business, including tax credits; and 3) providing technical assistance to business including exporting, manufacturing assistance, regulatory guidance, and serve as liaisons to, and coordinate with, outside partner and business organizations, as well as other divisions within DECD.**
>
> **Second, incorporate the recently transferred film office into the business development section and cross-train people in all economic development tax credits.**
>
> **Third, require that any department contacts with other organizations be made directly by the DECD business development specialist, not through a referral.**
>
> **Fourth, an on-line satisfaction form should be developed so that clients could evaluate the services received from the DECD business development teams. The results of the evaluations should be published as part of DECD's annual report, and the results also used to modify and improve business development services.**

Rationale. One of the ways that state government has addressed its current fiscal crisis is through implementing a recent retirement incentive plan, with more than 3,000 state employees taking the incentive. With such reductions in staff – 16 General Fund positions at DECD -- state agencies cannot maintain a "business as usual" culture. This provides an opportunity to consolidate functions and reorganize so that services can be delivered without filling vacancies. Program review staff believes these modifications and restructuring to business development at DECD should achieve that goal.

Further, with the state's fiscal situation, little financial assistance is likely to be available for individual businesses; thus, staff at DECD must refocus on what other technical assistance the department can provide. (Program review recommends all direct financial assistance programs be transferred to the consolidated quasi-public, see recommendation on page 18.) The technical assistance DECD provides should be more than referring clients to other agencies and organizations, but rather working directly with businesses, and DECD partners and organizations to ensure that companies, especially small businesses, receive the help they need.

DECD staff, as specialists in the economic development field, should build (or have built) relationships with its partner agencies, so that they know the person who can best assist a business with an issue. Whether the assistance is helping a business with an energy efficiency fund application, or obtaining an inland wetland permit, DECD should take an active, lead role, not a passive, referral one. Further, with budget cuts in grants and contracts to outside partners, like the regional planning agencies and the Connecticut Center for Advanced Technology, the level of services those partners can provide is in jeopardy. To compensate, DECD will have to increase the depth and breadth of its services to businesses. Therefore, the DECD specialists should be well-informed of all programs and assistance available and communicate that to business. (See recommendation below on ARRA funding.)

The business development specialists should be visible -- out in the field, attending chamber of commerce meetings, business expos, and cluster industry meetings – and taking every opportunity to let companies know that the state wants them in Connecticut. Slogans (e.g., "You Belong in Connecticut") and marketing materials that promote Connecticut's business environment will do little if there is no agency follow-through and support.

Finally, DECD currently provides a hard copy evaluation on the back of its client service form. Committee staff asked DECD to provide the results of the evaluations over a recent time period, but DECD did not respond. DECD should provide clients with an evaluation form online, make the results public in its annual report, and used the results to improve services.

Funding

Another way that the state's economic development agencies can assist in business development is through obtaining and leveraging financial assistance from other sources, particularly the federal government. A primary funding source is the federal Economic Development Administration (EDA), a division of the U.S. Department of Commerce.

Federal EDA. The Federal Economic Development Administration states its mission is to "promote innovation and competitiveness, preparing American regions for growth and success in the worldwide economy (and will) fulfill its mission by fostering entrepreneurship, innovation and productivity through investments in infrastructure, development, capacity building and business development." (U.S. CFR 300.1)

In the program review briefing report, committee staff reported federal EDA grant activity for Connecticut for 2007 was one grant to UConn for $64,000. Nationwide, the state placed last for receipt of grants from the federal EDA. Reports for 2008 and 2009 still have not been published, but PRI staff obtained EDA data for Connecticut for those two years, which are shown in Table I-4 below. As the table indicates, there were several grants to regional planning agencies and to towns, but, other than continuation of the UConn grant, no state agency or project received EDA grant assistance for 2008 or 2009. At the briefing, some committee members spoke of the importance of not leaving any federal dollars "on the table", especially during the state's current fiscal difficulties.

Table I-4. Federal Economic Development Grants To Connecticut – 2008-2009		
Year/type	**Grantees**	**Award**
2009 -University center	University of Connecticut	$110,000
2009 – Planning	Central CT Regional Planning agency	$64,000
2009 –Title IX – roads	City of Derby	$1,000,000
2009 – Access roads	City of New Britain	$1,250,000
2009 – Planning	Shelton Economic Development Corp.	$80,000
2009 – Roads	City of Hamden	$550,000
2009 Total	6 projects	$3,054,000
2008 – University Center	University of Connecticut	$110,000
2008 – Planning	Town of Ledyard	$100,000
2008 – Planning	City of Hartford	$75,000
2008 Total	3 projects	$285,000
Source: Federal Economic Development Administration		

Each federal EDA grant must be matched with the same amount from the grantee. The grants are competitive, and not formula-based, and therefore funding is not a certainty. However, DECD could at least apply for EDA grants with the possibility of matching some of the current state funding that goes to support entrepreneurial centers, incubation programs or other potentially qualifying activity. Therefore, program review staff recommends:

The Department of Economic and Community Development and the Office of Policy and Management should aggressively pursue funding opportunities with the federal Economic Development Administration, and determine where state assistance could be used as matching funds for the EDA grants.

ARRA funding. Another opportunity for the Department of Economic and Community Development to assist businesses in the state is through better information, coordination and leadership in the American Recovery and Reinvestment Act (federal stimulus) funding. DECD has recently designated its director of business development to be the agency's stimulus accountability officer, and DECD does provide some information about ARRA funding on the department's website. But the information targeted to business provides a link listing all potential stimulus programs, along with contact information, broad eligibility requirements and closing dates.

To date, however, most of the department's efforts have been focused on ARRA assistance that would benefit towns and communities. Six towns and public housing authorities have received a total of $3.4 million in funding, and some of that may well funnel through to individual businesses. In addition, DECD is the lead agency on a combined application to federal HUD for $45 million in additional neighborhood stabilization funding. DECD has also been designated to receive $19 million in weatherization assistance funding (from the state Department of Social Services) and DECD is currently reviewing bids on its request for proposals which were due in November 2009.

Further, while DECD indicates it is providing marketing and technical assistance to businesses interested in stimulus funding, that assistance to date has been:

- providing a letter of support to Greater New Haven for a CT Clean Cities Award, ($13.5m);
- responding to 21 inquiries and making appropriate referrals; and
- coordinating with Connecticut Innovation Inc. and the Clean Energy Fund on potential projects.

Program review staff believes the lead economic development agency should be doing more. For example, it should be exploring if some of the proposals in the state economic strategic plan might be eligible for ARRA funding. One of the recommendations in the plan calls for investing in Connecticut's maritime ports, and similar recommendations have been made in the past[13] but funding has been an issue. Availability of ports as an economic driver is an area that Connecticut could capitalize on, since many states do not have such access, and thriving ports have been shown to increase a state's (or country's) economic competitiveness. However, of the more than $571 million in ARRA funds awarded to the state Department of Transportation, more than half is allocated to highway infrastructure and only $2.9 million to small shipyards, none of which appears allocated to improve viability and accessibility of ports.

Two recently announced ARRA state programs – one for $135 million and the second for $90 million – use federally backed bonds to be issued by the Connecticut Development Authority. This funding is allocated to counties and the state's five major cities for "shovel-ready" projects in 62 designated "recovery zones" in the state, and grants will be awarded based on criteria established by CDA and DECD.

DECD should be actively working with local economic development directors, towns and cities on the ARRA funding. This should not just include website information about the available funding, but also direct contact about what the requirements are, what projects are eligible, and assistance with completion of the application process. The funding will do no good if local towns and other eligible entities do not know of their availability; how to apply; or the criteria for acceptance. The application form for this funding can be completed online on CDA's website, which is a positive step. Once the award criteria are established those should be communicated clearly as well. The administering agencies should continue to make the process as simple, transparent, and expedited as possible since the stimulus funding is intended to spur and accelerate economic recovery.

The Connecticut Business and Industry Association early in 2009 posted on its website total ARRA dollar amounts and what areas of the economy the assistance was targeting, thus providing some information to different businesses of what stimulus monies might be available to them. For example, $18 billion in ARRA has been designated nationwide to expedite the development and use of electronic medical records. It is unclear how much of this money might come to Connecticut, but DECD could be working with the technology industry cluster to ensure

[13] *Connecticut Strategic Economic Framework,* Connecticut Regional Institute for the 21st Century, November 1999 (also known as the Gallis report).

that Connecticut garners a portion, and then help publicize or promote it. Therefore, program review staff recommends:

> **The business development teams at DECD should research the ARRA funding available to Connecticut, what businesses and industry areas might be eligible, what the criteria are for receiving funding, and work with partner agencies, like cluster organizations, towns, and others to inform businesses and assist, whenever possible, with the application process. DECD should also publicize on its website the technical assistance that it can provide to business in seeking and obtaining ARRA funding.**

<u>Develop a Comprehensive Innovation Policy</u>

- ***Recognize that a knowledge/innovation economy involves more than one agency -- education, higher education, and economic development all play a role***
- ***Ensure that K-12 education system meets high standards in science, technology, engineering, and mathematics***
- ***Align post-secondary education to support the economy***
- ***Implement innovation-based economic policies***
- ***Invest in innovation and promote the transfer of research and development from education institutions to commercialization***

<u>Improve Access to Seed and Venture Capital</u>

- ***Provide tax credits or other measures that stimulate "angel" investments***
- ***Build an innovation network connecting entrepreneurs with investors and services***

The National Governors Association's best practices for developing a comprehensive innovation policy are presented above. The practices encompass a multifaceted approach to building an innovative economy, both through broad policy development aimed at education and investments in human capital to more narrow strategies targeting specific types of investment activity.

As noted in the briefing report, one of Connecticut's competitive advantages is its reputation as a center for innovation and technology. In 2008, the state ranked high in two national reports that grades states according to benchmarks around innovation. The Kaufmann State of the New Economy ranked Connecticut sixth highest, and the Milken State Technology and Science Index ranked the state seventh.

The Connecticut Innovation Scorecard, developed by PRI staff based on similar indexes created by other states and presented in the October 6, 2009 briefing report, showed that education capacity was generally a state asset, but that recent scores in math and science in the lower grades were cause for concern. A pipeline of well-educated workers, especially in STEM -- science, technology, engineering, and math – is critical to maintaining an innovative edge. The recent economic strategic plan addresses these concerns and lays out 10 recommendations for K-12 education, as well as higher education, adult literacy, and workforce training needs. The plan calls for greater integration of policy development, planning and program implementation of education and workforce development agencies, and indicates it should be achieved with interagency cabinet and policy/budget teams rather than a restructuring or consolidation of state agencies.

The economic strategic plan also recommends enhancing programs that prepare workers for the jobs of the future including health care, digital media, and green technology, among others. The economic competitiveness study does not examine the education and workforce issues as another 2009 committee study on alignment of postsecondary education and employment addresses that area, and makes recommendations for improvement.

The staff briefing report noted that Connecticut has focused on innovation policies and competitiveness beginning in the early 1990s. Since then, various task forces, study groups and consultants have conducted reviews on a range of aspects that link innovation and the New Economy. A few examples of reports issued in the past five years include:

- Generating the Talent and Innovations for the 21st Century Knowledge Economy: A Report on Connecticut's Technology Preparedness, February 2004;[14]
- Building Upon Connecticut's Core Competencies in the Knowledge Economy, May 2005;[15] and
- A Talent-Based Strategy to Keep Connecticut Competitive in the 21st Century, February 2007.[16]

Many of these reports included proposals for initiatives and investments to promote technology and innovation in Connecticut. Some of these proposals have been implemented and others have not, and still others have been started but have not survived, typically due to lack of funding. Many of the recommendations contained in the September 2009 economic strategic plan around innovation, talent, and technology come from the reports cited above. The plan uses the state's strengths and assets identified in those reports as a focus for investments, and calls for the creation of several funds and entities, including:

- A CTech Fund for the 21st Century;
- Technology Company Working Capital Fund Program;
- International Opportunities Program; and
- An Office of Clinical Trials.

All of these initiatives will require funding (e.g., $20 million in public money for the CTech Fund) but it is unclear where the public funding will come from for most of the proposals. Further, even funds already established for research and development appear to be in jeopardy in the state's current fiscal crisis. For example, the state committed $100 million over 10 years to stem cell research, utilizing the State's Tobacco Settlement Fund. Since passage of the legislation in 2005, $39.42 million has been allocated to support 78 researchers at Yale, 115 scientists at UConn, and two graduate students and a technician at Wesleyan.[17] However, the Deficit Mitigation Plan issued by the governor in November 2009 calls for the $10 million in FY 10 funding to be redirected to fill the budget gap, with another $6 million of the tobacco

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[14] Battelle Technology Partnership Practice
[15] Prepared for Office for Workforce Competitiveness and prepared by Battelle Technology Partnership Practice
[16] ibid
[17] Report to Governor and General Assembly, "An Act Permitting Stem Cell Research and Banning the Cloning of Human Embryos," June 30, 2009.

settlement money that had been used for biomedical research also be redirected to the budget deficits.

Tax credits are another way Connecticut has supported research and development. Since 2000, $175 million worth of research and development tax credits have been granted. However, this represents only 13 percent of the total value of all tax credits issued, and like other state financial assistance, indicates weak state support for building the state's innovation capacity. Since innovation investments have not been well funded in the past, it is crucial that they maintain some level of funding or the state's future competitiveness will be harmed. Committee staff makes recommendations below to enhance investment in this area.

Investing in Entrepreneurial Activity

Throughout the study, program review staff heard from many business groups and other organizations that the greatest challenge entrepreneurs face in Connecticut is access to early-stage or seed capital. Capital at this stage is crucial since an early-stage business needs funds but banks view such ventures as too risky and the entrepreneur has typically exhausted capital from family and friends.

In the past, venture capital funding for early-stage companies was available, however more recently venture money appears to be decreasing. In 1995, start-up and early-stage companies received 39 percent of venture capital investment nationwide, but by 2008, only 25 percent of venture capital funding went to early stage companies.[18] Economic and financial experts believe that venture capitalists are not willing to wait the 10 to 15 years it requires to see a return on investment from seed companies. The amounts of money required by early stage companies are too small for venture capitalists and not worth the administrative costs, and venture capital funds typically do not consider investments under $1-2 million.[19]

"Angel" investors are increasingly providing the capital to fill this gap. Angel investors are typically wealthy individuals with business or technology backgrounds who provide capital, connections, and guidance to entrepreneurs. Nationally, the average angel group investment is between $200,000 and $500,000, whereas the average venture capital investment is $7 million.[20] Angels are typically patient investors, holding investments on average eight years before expecting a return, while venture capitalists typically look for an exit strategy in five years (for example, an initial public offering or sale).

Often these small start-up companies have an innovation- or technology-based product or service. These potential technology-based companies generally need outside capital to grow and prosper, but these companies are often risky investments and many will not succeed. However, those that receive funding at fairly early stages of development are more likely to succeed and grow than those without funding. The stages of development where this financing can be targeted are:

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[18] PricewaterhouseCoopers MoneyTree historical trend data
[19] www.entrepreneurshipfoundation.org
[20] PricewaterhouseCoopers MoneyTree historical trend data

- Seed/Start-up Stage
    - initial stage of development
    - concept or product under development; usually not fully operational
    - usually in existence for less than 18 months
- Early Stage
    - product or service in testing or pilot production
    - may be commercially available and may or may not be generating revenues
    - usually in business less than three years
- Expansion Stage
    - Product or service in production and available commercially
    - significant revenue growth
    - may or may not yet be profitable
- Later Stage
    - Product or service is widely available
    - generating positive cash flow and ongoing revenue

In addition to funding, early-stage companies need other types of support to increase success. The NGA has studied this area and recommends that states undertake several strategies to encourage the formation of angel groups and expand early-stage investment, particularly since it is an area underserved by the private market. These government actions include:

- promote seminars on private equity investment for current and potential angel investors;
- assist entrepreneurs by connecting them with existing entrepreneurship education and services;
- facilitate the formation of statewide angel group networks;
- ensure angel investors are represented on state economic development advisory boards; and
- identify and collect metrics to monitor the impact of policies to encourage angel investment.

Funding and Support for Entrepreneurs in Connecticut

Connecticut has the potential to build a robust network of angel investors to fill in the gap that exists for early-stage funding. However, not only is funding required but also technical support. Over the years, the state has started several initiatives focused on building an innovation infrastructure, however, often the initiatives are not sustained. This section describes the potential for early-stage funding in Connecticut, technical support that is or has been provided in the state, and makes policy recommendations to support an innovation-based economy.

Venture capital. Although there is no known data source on overall capital invested in innovative, high-tech companies, venture capital funding is one aspect of the market where some data are available that provide a general sense of financing for entrepreneurial activity in the state. As reported in the October briefing report, Connecticut saw a decrease of greater than 50 percent in venture capital investments in 2008 from 2007. This decrease is measured as venture capital investments per $1,000 in state GDP, and not in overall dollars, but industry experts caution that investments must be looked at on a continuum and not just from one year to another. A couple of factors could have caused the short-term drop. One explanation is venture capitalists were holding onto reserve cash in this recession. The national average also decreased in 2008 from the previous year, but only by eight percent.

Data for a slightly expanded time period also indicate cause for concern. Over the past four years, Connecticut has seen a decrease in venture capital funding while the nation saw an increase of 22 percent. The decrease in Connecticut of 42 percent was even greater than other competitor states in the East, such as New Jersey and Maryland, which experienced decreases of 22 and 25 percent, respectively.

Another explanation for the downward trends experienced in Connecticut is that the potential "deal flow" does not exist. If the state does not foster and grow young companies there will not be an adequate number of start-ups that have matured; thus potential investments are scarce for venture capitalists. This sentiment – inadequate supply of potential investments in entrepreneurial activity -- was repeatedly mentioned to staff in interviews with industry experts and angel investors.

Although Connecticut is a small state, a robust venture capital industry exists in the state; the companies just may not be investing in Connecticut businesses. In the second quarter of 2009, Canaan Partners in Westport topped the list as the most active venture firm in the country closing 18 deals.[21] Two other firms making the list included Foundation Medical Partners in Rowayton and Connecticut Innovations. For the most recent quarter of data available (third quarter 2009), of the deals closed by private Connecticut-based venture capital firms, none made investments in Connecticut companies. All Connecticut Innovations investments were in Connecticut companies, but the quasi-public is required to do so by statute.

Angel groups. Connecticut has two formally organized groups active around this type of investing. The Angel Investor Forum, with 50-60 investors, and the Angel Guild, with 15-20 investors, represent the two largest active angel groups in the state. The Angel Investor Forum is a member of the Angel Capital Association, a national organization sponsored by the Kauffman Foundation. The Angel Guild is part of the Connecticut Ventures Group, which among its activities hosts a business plan competition for Connecticut students, linking the investing community with entrepreneurs. There may be other informal angel groups at work in the state, but the numbers are unknown.

In FY 07, through a Manufacturing Assistance Act (MAA) grant, the Connecticut Ventures Group received $90,000 in funding and leveraged $90,000 in private funding to administer the Angel Guild. This project was designed to help form an angel investor club and

[21] PricewaterhouseCoopers Money Tree Report, 2Q 2009 Summary

educate and recruit new angel investors. However, only one year of funding was provided; not sufficient time to launch and sustain such a program.

Connecticut has the potential to build a thriving angel community in the state given the wealth that exists here. According to the Angel Investor Forum website, "Connecticut has more angels per capita than any other state." Connecticut now must implement policies to help direct this wealth at assisting potential companies within the state grow and develop.

Building an innovation network. For four years, DECD, through the MAA, provided funding to the Connecticut Technology Council (CTC) to develop and manage the Innovation Pipeline Accelerator and Innovation Database. The purpose of the statewide Innovation Pipeline was to build an infrastructure for: connecting entrepreneurs with either other entrepreneurs or existing companies seeking new products; helping university researchers develop promising ideas; and serving as a conduit between the investor community and potential new companies. As part of its involvement, the CTC also completed the due diligence on new enterprises, helping to identify potential companies, and assisting promising entrepreneurs develop robust business plans in an effort to increase their success in finding funding. The Pipeline provided a "deal flow" of approximately 10-15 deals per month for the Angel Investor Forum, Connecticut's largest angel group. In other words, 10 to 15 entrepreneurs were matched with investors each month. This project represented a state-wide attempt at building the foundation for a robust network of connecting funders and entrepreneurs.

State funding for the project was also matched by CTC funding of approximately $42,000 annually. In addition, considerable in-kind service contributions from lawyers, accountants, and consultants were provided to companies participating in the project to help them start and grow their business. Funding for the Innovation Pipeline started in 2004 and averaged $165,500 a year. However, funding was eliminated for this program in 2009 due to the fiscal situation of the state.

Small Business Innovation Research. Another source of funding for innovative and technology-based companies is the federal SBIR/STTR grant awards that total approximately $2 billion annually nationwide. As cited in the briefing report, Connecticut companies received 107 grants totaling $32.5 million in 2008, ranking 15th nationwide for the 2003-2005 period (the most recent comparative data available).

However, not only do small businesses need financial support but they often need technical assistance, mentoring, and guidance. The state-run office in Connecticut that provides this assistance for high-tech, innovative entrepreneurs is the Small Business Innovation Research office located at Connecticut Innovations, Inc. (from its inception in 2004 to April 2009, the SBIR office had been located at the Connecticut Center for Advanced Technology).

The primary focus of the office is to assist high-tech small businesses and entrepreneurs compete for and win the highly competitive SBIR/STTR federal grants. However, the SBIR office, with three employees, also administers various programs for businesses seeking SBIR funding that are aimed at matching businesses, entrepreneurs, and others involved in technology and innovation. The following programs were created and implemented by the staff in the office based on needs recognized from working directly with entrepreneurs: the Careers for Engineers program, Collaborate to Innovate, Partner with a Prime, Partner with a Professor, Gateway to Grants, and Matches for Money.

The CT SBIR office is not only focused on developing young companies, but through the Career for Engineers program the office helps match unemployed engineers -- many of them laid off by large companies -- with small businesses looking for experienced engineers. This program started in August 2009 and 74 matches have been made, helping Connecticut keep its talented and educated workforce in the state. These types of programs aimed at helping entrepreneurs and small businesses are crucial for success in the New Economy.

The SBIR office was also asked to host the national SBIR conference in April 2010. This conference brings together federal agencies, federal laboratories, university tech transfer offices, entrepreneurs, angel investors, and both small and large businesses. This conference provides a great opportunity for Connecticut entrepreneurs to showcase their products and ideas, find investors, and for large companies to find potential new products. The conference will also present a venue for marketing Connecticut small businesses and for the state in general. The conference and the opportunities it offers to small business and the state's economy is an example of a broad-based strategy that should be widely supported by all the state's economic development agencies. Yet, state funding for the SBIR office was terminated for FY 2010, and now its costs must be assumed by CII.

As concluded in the briefing report and discussed earlier in this report, Connecticut's economic development strategies have primarily focused on an older model. Connecticut must refocus these strategies more on small businesses and building the services in the state that assist businesses at the grass-roots level. Both technical assistance and capital is needed to develop and grow innovation.

A multi-pronged, *sustained* approach is needed to spur angel investing and address the gap in early-stage financing for start-up companies, and to continue the technical support and services that small high-tech businesses require. Therefore, PRI staff recommends that the state's strategy include:

- **Implement an "angel" tax credit program whereby:**

  - **<u>Credit Amount:</u> Twenty-five percent of an investor's cash investment, provided no individual credit shall be greater than $125,000, in qualified, early-stage enterprises in high-tech industries with an aggregate cap of $6 million per year for the first three years and then decreasing to $3 million annually.**

  - **<u>Applicable Tax:</u> Personal income tax**

  - **<u>Eligibility Criteria</u>: Investments shall be in a business that:**

- **has been approved as a qualified Connecticut business by Connecticut Innovations, Incorporated (as modified in prior recommendation);**

- **has had annual gross revenues of less than $5 million in the most recent income year;**

- **has fewer than twenty-five employees, more than half of whom reside in the state;**

- **has been operating in the state for less than 10 consecutive years;**

- **is primarily owned by the management of the business and their families; and**

- **has received less than $1 million in tax credits provided by this section in any year.**

- **<u>Carry Forward</u>: The amount of credit allowed to any one investor shall not exceed the amount of tax due from such investor. Any tax credit not used may be carried forward five years.**

- **<u>Effectiveness review</u>: a review of its effectiveness conducted by July 1, 2015, and a sunset date of July 1, 2020.**

➢ **Include a Connecticut angel investor on the board of Connecticut Innovations, Inc. (as modified in prior recommendation) and the Small Business Innovation Research advisory board;**

➢ **Continue funding the Innovation Pipeline Accelerator for two more years;**

➢ **Create a "sidecar" fund operating within Connecticut Innovations Inc., with 10 percent of the fund set aside for university student entrepreneurs;**

➢ **Provide state matching funds to SBIR/STTR Phase I grants at 50 percent, up to $50,000 per grant; and**

➢ **DECD and the combined CII/CDA organization shall create a slogan/brand for Connecticut that emphasizes the state as a place for innovation. The slogan shall be visible at the top of each agency's website and on all marketing materials.**

Rationale. Connecticut needs to make a commitment to investing in innovation-based policies. Private investors do not want to make decisions based on a certain set of facts and incentives only to be told a year or two later that the rules have changed. In order for these policies to be successful, they must be sustained over the long-term.

Connecticut has not enjoyed a good track record for sustaining public investments as demonstrated by the termination of funding for the innovation pipeline, the SBIR office, and the angel guild. While all together administrative costs for these programs totaled only approximately $500,000 annually, the programs often represent the state's only support and assistance many individuals and small companies receive. In order to reduce some of the risk involved with new ventures, investors and entrepreneurs need the assurance and stability that Connecticut is a state committed to fostering and growing the entrepreneurial culture of the state.

Angel tax credit. As of the beginning of 2008, 18 states, listed in Table I-5 below, have implemented tax credits to incentivize angel investing. The NGA notes that angel investment tax credits can be controversial and their impact has not been rigorously evaluated due to the difficulty in determining direct, indirect, and induced economic benefits for the state.

Table I-5: States with Angel Investment Tax Credits	
Arizona	Hawaii
Indiana	Iowa
Kansas	Louisiana
Maine	New Jersey
New Mexico	North Carolina
North Dakota	Ohio
Oklahoma	Oregon
Vermont	Virginia
West Virginia	Wisconsin
Source: National Governors Association Center for Best Practices, February 2008	

However, several principles from other states' experiences can serve as guidance in structuring a tax credit for angel investments. For example, if the investment credit is set too low, it will not spark activity. This occurred in Vermont where a 10 percent credit did not result in a significant increase in investments. In Wisconsin, success in growing angel investment came from implementing two policies simultaneously – state administrative support for creating angel groups and establishment of a tax credit. The administrator of the Wisconsin Angel Network noted that having the tax credit provided a marketing tool and a reason for angels to come together. Providing an investment tax credit will energize current angel investors and attract potential angel investors that might have previously considered investing in early stage companies too risky. The tax credit in essence lowers the risk for the investor.

In 2005, DECD commissioned the Connecticut Academy of Science and Engineering (CASE) to do an assessment of seed funding in the state. That study estimated that for every $1 million in state funding for early-stage businesses, six new companies will be created, with one or two being successful and each creating 100 or so new or additional jobs.[22] With $6 million in

[22] "Assessment of a Connecticut Technology Seed Capital Fund Program," CASE, June 2005, pg. 14.

angel investment tax credits issued annually, using CASE estimates, that would mean approximately 36 new companies being created with six to 12 of these being successful and creating high-tech, high-wage jobs each year.

The state's economic strategic plan also recommends implementing an Angel Investor Tax Credit to individuals, corporations, and institutions investing in qualified, early-stage enterprise in targeted areas. An angel investor tax credit was proposed in the 2009 legislative session, which was referred out of the Commerce Committee to the Senate. The bill's fiscal note had a one-time DRS cost of $150,000-$200,000 for systems upgrades and costs for a part-time or full-time DECD staff person to review applications, and the bill was never put to a vote. The program review committee staff recommendation to have CII approve the credits and to eliminate other tax credits (recommended in Section II) should free up resources for DRS to modify its system and make the credit administration possible.

Board membership. Having an angel investor on the boards of both CI and the SBIR office will help connect investors with entrepreneurs. Companies applying for SBIR grants, especially Phase II grants, often have promising technologies in development. The award provides a signal to investors that these technologies hold promise and their investments could be leveraged with the federal early-stage funding grants. Also, having an investor on the boards adds a private dimension to aspects important to an investor when evaluating an investment opportunity.

Innovation Pipeline. As noted in the NGA best practices and literature on the New Economy, state level infrastructure support is necessary in order to create a network of entrepreneurs and innovation-based businesses. However, just when the Innovation Pipeline project was reaching a critical mass and at the cusp of achieving a thriving innovation network, state funding stopped. Program review staff believes funding for this program should continue for another two years to continue the progress that had been made. Two more years of funding will give the project time to rebuild and also sets a goal up-front for the project to build itself into a self-sustaining network for the state.

Sidecar fund. A "sidecar" fund, defined as a committed public source of capital that invests alongside an angel group, will also increase the funding available to new entrepreneurs and will add to the number of potential new companies in the state. A sidecar fund can make it easier for angels to manage their investments in subsequent rounds of financing for a new company, increasing the chances the company will succeed. A sidecar fund allows public money to follow private investments leaving the due diligence and administrative costs of vetting investments to be borne by the private market. Setting aside a portion to assist young entrepreneurs from the state's universities will help these new ideas get off the ground and grow new companies within the state while keeping young talented people in Connecticut.

Ohio's sidecar fund is a model example often cited by angel investors and those involved in the industry. That state's Third Frontier program – a 10-year, $1.6 billion commitment to establish the state as an innovation leader -- has an early-stage funding initiative which, since 2002, has invested $4 million alongside angel investor groups. The state's Pre-Seed Fund also provides funding to venture groups focused on early-stage financing, and to universities and hospitals to assist in the development of technologies that have the potential to be spun-off into start-up companies. Although many factors contribute to increases in venture capital funding, Ohio has seen an increase in venture capital investments per GDP of more than 100 percent since implementation of the sidecar fund.

SBIR matching grants. Providing matching funds to Phase I awardees should help promising companies in Connecticut make it to the next funding level, allowing more time to grow and thus have a greater chance for success. By matching state money with federal money, the administrative cost of identifying and vetting promising companies is undertaken by the federal government. The companies that are awarded funding are presumably less risky since the federal government has done the due diligence on the companies. Program review staff was unable to determine the exact number of states that have matching SBIR programs, but several states across the nation have been providing matching funds to these promising companies for years. Table I-6 highlights a few states that provide matching funds and some aspects of their programs.

Table I-6: SBIR/STTR State Matching Fund Programs	
State	**Matching dollars**
New Jersey	Bridge grants up to $50,000 – companies that received Phase I awards and are awaiting Phase II awards
North Carolina	Phase I: 100% match up to $100,000 – 75% awarded when receive Phase 1, 25% awarded when submit Phase 2 application Since 2006, issued $8 million in matching grants
South Carolina	Phase I: 100% match up to $100,000 FY10 max amount of awards $750,000
Indiana	Phase I: 100% match
Source: Various state economic development websites	

Most other state assistance in Connecticut is targeted at larger companies. If a matching grant program were implemented, it would demonstrate that Connecticut is also committed to smaller, early-stage companies as well. In 2008, 63 Phase I awards were made to Connecticut businesses. If the number of awards remains the same, providing a matching grant would cost the state approximately $3.15 million for a match of 50 percent on each award at a maximum of $50,000 per award. Given the current economic conditions of the state, PRI staff recognizes funding is limited. However, the legislature, recognizing the long-term importance of programs offered by CII, recommended authorization of $24 million in bond funding in fiscal years 2008 and 2009 of which $20.5 million remains unallocated. In contrast, the average amount of a single grant through the Manufacturing Assistance Act has been $2 million, although grants have not been awarded in several fiscal years.

Innovative brand for the state. The Department of Economic Community Development's website does not emphasize or have a banner statement showing Connecticut's commitment to innovation. Not only does Connecticut need to implement innovation-based policies, the state must also market itself as a place of innovation; policies without a message will go unnoticed.

Getting the message out that Connecticut is a place of innovation does not require resources and could be implemented today. The following brands appear on other state's economic development agency websites and provide an example of what could be done in Connecticut: "Team Washington: Innovation is in our nature;" "Pennsylvania: State of Innovation;" and "Florida: Innovation Hub of the Americas."

These recommendations aim to fill a gap that exists in the market, early-stage funding, and to remain competitive with other states; many of them have already implemented similar policies. For the state to achieve success in the New Economy it must spur early stage investing, create the angel infrastructure, brand Connecticut as a place friendly to innovation, and link potential investors with entrepreneurs. The time to demonstrate the commitment to building the innovation economy is crucial and immediate; otherwise Connecticut will continue to lose ground in the global market.

<u>Create a coherent, market-driven trade and international development system</u>

- ***Recognize the global economy offers opportunities for growth and promote exporting as part of economic development mission***
- ***Focus on exporting competitiveness, market share, and strategic position, not just export numbers***
- ***Leverage state investments and resources with those of federal, private, nonprofit, and regional organizations***
- ***Develop strategies that assist industries (and cluster associations) identify potential markets abroad, as well as promote the state as a location for business or education***
- ***Create and foster relationships between exporters and potential exporters, banking, and other organizations that might offer assistance***
- ***Identify obstacles to exporting and work to resolve***
- ***Recognize the governor can serve a crucial role as advocate of international development and chief economic ambassador of the state***

Program review staff believes that the state's policies around creating and promotion of market-driven international trade as part of the state and regional economy are deficient, and the state does little to implement the NGA best practices in this area. First, DECD does not allocate nearly sufficient department resources to the international trade area. While the department's website lists international assistance among the agency's business development support functions, there no longer is anyone assigned full-time to that activity. One person left under the retirement incentive plan in June of 2009, and the only remaining person who had been serving in the exporting office is now assigned to the commissioners' office, for special projects. A recent organizational chart of DECD, after the retirements, does not list exporting or international trade functions in the department.

Exporting activity has long been recognized as a way to enhance the state's competitiveness. In 1994, the legislature passed P.A. 94-237, calling for DECD to establish a number of programs and initiatives including: an exporting services database; a program aimed at attracting foreign investment to the state; an export promotion program; and creation of an International Trade Council to advise and assist DECD. However, since no additional funding was allocated; the programs were all required to be established within the department's existing resources, and most were never implemented.

Despite lack of implementation of state policies and strategies to assist exporting, or staff resources dedicated to that function, state exporting activity thrived in recent years, as more Connecticut goods were purchased in global markets, including industrial machinery, aircraft and component parts, medical and surgical equipment, and plastics. Connecticut's exporting activity almost doubled from about $8 billion in 2003 to $15 billion in 2008.

Since the recession has begun, Connecticut's export activity has not dropped as much as other states in the comparative group, or nationally. Table I-7 shows: the percentage increase in exporting activity between 2006 and 2008; the drop in activity from the end of the third quarter of 2008 to September 30, 2009; and the net change for the 2006-2009 time period. As the table shows, Connecticut has fared better than any of the comparative states in terms of holding on to most recent gains in exporting.

Table I-7. Recent Percent Changes in Exporting Activity: Connecticut Compared to Other States

State	% Change 2006-2008	% Change 3rd q 2008-2009	Net Change 06-09
CT	23.5	-11.9	11.6
MA	17.0	-21.0	-4.0
NC	17.1	-15.5	1.6
PA	28.6	-20.1	8.5
VA	31.4	-24.3	7.3
NTL Average	23.9	-23.8	0.2
Source: World Institute for Strategic Economic Research			

Committee staff believes that much of this growth, and the relatively mild drop in exporting in 2009, were achieved without aggressive state economic development agency assistance. Results of a 2009 CBIA survey on International Trade showed that more than half of the respondents were already involved in trade abroad, and about 10 percent had only entered the global market in the previous six months. Many of the respondents said they wanted to engage in exporting but lacked knowledge of requirements for international trade including export regulation, foreign markets, contract procurement and other potential opportunities. However, even many companies already engaged in exporting had no knowledge of the state and federal government assistance to businesses wishing to initiate or expand trade abroad.

Lack of knowledge of government assistance to business regarding exporting is certainly an issue. Even if companies were informed however, it is unclear how adequate the services would be given the comparatively sparse government resources aimed at international trade in Connecticut. As stated, during the past year, DECD has reduced its staffing to exporting to less than a full-time person. At the same time as state resources were dwindling, so was the staffing at Connecticut's only federal U.S. Department of Commerce Export Assistance Center (EAC), located in Middletown. According to staff there, the office is supposed to have a director, three trade specialists, and one commercial officer, and 1-2 unpaid student interns. The current staffing level is down two trade specialists, leaving only three full-time professional staff.

Other states. Compared to other states, Connecticut allocates scant resources to exporting. For example, Virginia, which has only a 25 percent greater dollar value of exporting activity (almost $19 billion compared to Connecticut's $15 billion), dedicates 19 people in 3 different divisions and state regions to support international trade and investment. Further, the state's exporting website is colorful and inviting, informative, and up-to-date, with a schedule of educational and technical sessions available to businesses, as well as highlights of companies' exporting success stories.

In Massachusetts, the state matches U.S. Small Business Administration funds (at a 2:1 ratio of federal to state $) to its small business development centers to add a focus on training sessions around exporting, especially for small businesses. The Mass Export Center is staffed with six full-time people, and provides many sessions on international trade regulations and the like throughout the year; the center's website indicates two upcoming events around international trade during the month of December. According to the center's staff, the Massachusetts office receives inquiries from many Connecticut companies, and frequently businesses from here participate if space allows. In addition, Massachusetts operates an Office of International Trade and Investment (MOITI), with eight persons located in Boston, and one at each of the state's four international offices. That office concentrates primarily on international trade shows and attracting foreign investment to Massachusetts. For example, the office is organizing a Massachusetts contingent to attend the Arab Health Trade Show in Dubai in January 2010, which would have special appeal to companies interested in exporting medical equipment.

Smaller states that do not have the numbers of staff Virginia or Massachusetts have also focused more effort on exporting than Connecticut. New Hampshire, for example, has combined its state, federal, and private resources to form the International Trade Resources Center (ITRC). The center provides a one-stop export assistance facility that includes among others: the U.S. Export-Import Bank; a representative of the state university system; the biomedical council; and a representative of the New Hampshire International Trade Association.

The link to the ITRC website is on the New Hampshire state government main website, an indication of the priority placed on trade and export in that state. The ITRC website provides an electronic one-stop site that offers businesses information about all the services that New Hampshire is collaboratively providing to support and promote exporting. The ITRC also provides an innovative, unique service that offers New Hampshire companies a "virtual address" in seven Asian countries and the United Kingdom. For a fairly low start-up cost ($350) and an ongoing monthly fee ($175), companies are provided a local mailing address, mail sorting and forwarding, and phone and fax numbers, as well as access to meeting rooms, workspace, video conferencing, and access to business advisors in that country.

New Hampshire also has established an arrangement with Citizens' Bank to assist businesses with sending and receiving international payments in over 25 foreign currencies in real-time exchange rates, and offers scheduled training sessions and ongoing support, especially aimed at small business.

While a smaller state in population and with a smaller state budget than Connecticut, New Hampshire seems to have used its resources to adopt two of the NGA best practices for promoting international trade: *to leverage state investments and resources with those of federal, private, nonprofit, and regional organizations; and to create and foster relationships between exporters and potential exporters, banking, and other organizations that might offer assistance.* In fact, New Hampshire's International Trade Resource Center has won several national awards, including one for its advertising.

The results in New Hampshire seem to be positive. While New Hampshire is not one of the states committee staff used for comparative purposes, either in the Innovation Scorecard in the briefing or for this report, staff did review recent trade activity for New Hampshire, and the net percent increase in exporting for that state for 2006 through 2009 was 14.53. This is higher than any of the comparative states listed in Table I-7 -- 25 percent higher than Connecticut's 11.54 percent growth, and much higher than 0.16 percent national average.

Connecticut. Unlike New Hampshire, Connecticut's efforts at collaboration and leveraging resources to support exporting are weak. Even if both federal and state government export assistance offices in Connecticut were at higher staffing levels, it would be advantageous to coordinate and collaborate more extensively than they do currently. However, with both government export assistance offices' combined full-time resources total at fewer than five people, coordination becomes even more imperative. Yet, for FFY 09, of the 14 in-state seminars and workshops sponsored by the U.S. EAC, only one was co-sponsored by DECD. Most of the other Connecticut sessions had co-sponsors including: area chambers of commerce, Northeast Utilities, the Secretary of the State, Congressman Courtney's office, or a community college.

DECD support of its federal counterpart is not only weak, but it seems the two government offices sometimes work at cross-purposes. One example is the information the two offices provide on their websites. The Eastern Trades Council (discussed below) is co-sponsoring, along with its member states in the Eastern region, a Business Development Mission to Turkey on March 13-19, 2010. The federal EAC in Middletown indicates the mission is co-sponsored by the Rhode Island Economic Development Corporation and makes no mention of Connecticut's co-sponsorship. The same mission is listed on DECD's website, but it does not list any of the other four international trade events the federal Export Assistance Centers are currently leading.

As mentioned in the briefing report, the U.S. DOC also has federal trade representatives in most countries, a feature that most states cannot replicate. Further, the federal exporting database can link state businesses with potential foreign buyers, distributors and buyers. The Middletown EAC indicates its database contains 2,000 Connecticut companies that receive information on exporting, and about 1,200 have used one or more of the office's services. The federal office charges for its services, depending on the size of the business, and DECD provides some financial reimbursement, but that availability is not communicated on the local US Export Assistance Office's website offering the services.

While the DECD financial reimbursement is limited to 50 percent of the fees -- up to $1,000 per company -- for FY 08 and FY 09, reimbursements totaled less than $5,000 for each year. It is important that the state DECD work with the federal exporting agency to ensure that state businesses access these connections abroad. Program review staff believes the low reimbursements indicate a problem: perhaps companies do not know about it; perhaps they do not qualify; or perhaps companies do not think the reimbursement amounts make it worth applying. Whatever the reason, DECD should be more proactive about ensuring that all businesses that could benefit from the U.S. EAC services can access them.

Website information. DECD does provide some information about international trade on its website. But, committee staff also finds that DECD's website to promote exporting is uninformative, uninviting, and out-of-date. The site states that DECD is committed to international trade, and that the department "serves as the lead facilitator and strategic catalyst of international activity . . . by developing two-way trade and investment opportunities, helping businesses enter new markets and expand its business base." But little on the website reveals how this is implemented. For example, the site provides no "success" stories of any businesses DECD has assisted, nor provides website links directly to a key DECD exporting partner, the Middletown office of the U.S. Department of Commerce (although the New England office is provided).

Further, DECD current website postings, a monthly review of trade and international matters appears more national in scope, and geared to numbers, like the U.S. trade deficit, than matters that might impact Connecticut. In other areas, postings do not appear to be updated regularly – the most recent exporters' newsletter is from 2007, and most recent trade alert is from 2006. As mentioned above, none of the upcoming U.S. DOC-sponsored trade missions is posted on the DECD website despite the fact that two may have particular appeal to Connecticut companies -- a medical trade mission to India and another to the Singapore Airshow, the third-largest airshow in the world. Similarly, the U.S. DOC-sponsored events for 2009 were not posted on DECD's website -- including 14 in-state seminars and workshops or any of the six international trade shows or development missions – held between October 1, 2009 and September 30, 2010. In fact DECD does not have an "Events Schedule" on its exporting assistance website.

Eastern Trades Council. The Department of Economic and Community Development is a member of the Eastern Trades Council (ETC), an entity that operates under the auspices of the Council of State Governments' Eastern Region Office. As the briefing report discussed, the ETC helps fund and organize international trade missions for businesses operating in any of the 10 states in the region. The ETC has led trade missions to several European, Middle Eastern, and Asian countries. It also has a permanent office in China that can assist businesses with market research, on exporting opportunities from the Northeast U.S. to China, introduce products to potential distributors in China, and serve as a liaison to the Chinese government and associations on behalf of ETC. But the link to the Eastern Trades Council is only one of many links listed on DECD's exporting assistance, and is not easy to locate, nor prominently featured.

While the DECD website is only one communication tool that alerts businesses to opportunities and services to initiate and expand exporting activity, program review staff believes it is indicative of the low priority given to international trade and exporting in Connecticut. Staff finds other indications are: lack of any staff in DECD assigned to exporting; failure to define obstacles, including use of CBIA survey results, to exporting and work to correct them; an inability or lack of willingness to collaborate among relevant government agencies; and a failure to include private partners to work on innovative ways that exporting assistance services can be still be delivered despite scarce resources, as New Hampshire has demonstrated.

Committee staff believes a multi-faceted approach to elevating and promoting exporting as a growth area for Connecticut's economy is needed and recommends the following:

The governor and the Connecticut Congressional Delegation should work to restore the U.S. Department of Commerce Export Assistance Center in Connecticut to its full staffing component. The governor's office could be used to draw attention to the staffing situation, and each Connecticut U.S.

senator and representative should be enlisted to advocate for the restoration of the positions to the federal administration.

The business development division within DECD should be reorganized using a team approach (as recommended above), with no new or refilled positions needed. One of the teams should be staffed with four people, assigned to technical assistance including exporting.

A memorandum of agreement should be developed between DECD and the U.S. Department of Commerce Export Assistance Center to partner on activities including:

- **jointly providing exporting informational sessions to businesses, as well as joint sponsorship and joint representation of international trade events held in Connecticut;**

- **aggressively promoting the services that U.S. Export Assistance Center can provide as well as DECD reimbursement to businesses for participation fees;**

- **finding innovative ways of supporting exporting activities;**

- **work with other government agencies (e.g., Small Business Administration) and private partners (e.g., banks, business trade groups) to coordinate and target the needed services, such as financing, or transportation;**

- **provide the expertise in the regulatory and licensing requirements that Connecticut companies indicate they need to access potential markets --either through staff research in-house, or seeking experts in the field from the private sector or the federal government – and offer the assistance at publicized workshops around the state;**

- **explore opportunities with similar export assistance agencies in neighboring states to maximize exporting prospects for businesses in the region; and**

- **establish an aggressive marketing campaign to promote Connecticut's export activity that:**

  - **highlights the unified federal/state team assistance approach;**
  - **features Connecticut's recent success in exporting;**
  - **demonstrates that exporting activity is a state priority -- for example, appearances and remarks by governor, by**

Congressional representatives at high profile business events; and

- **conveys exporting as a way to grow revenue, and create new jobs.**

DECD should upgrade its website to give more prominence to exporting activity, make that area of its website more colorful, inviting and user-friendly, provide more current useful information, and offer some success stories.

Funding for export assistance, including sponsorship of programs, helping companies access U.S. DOC services, marketing materials and website improvements, should come from the unallocated Manufacturers Assistance Act bond funding, upon approval of the Bond Commission.

Rationale: If these recommendations are implemented, they should provide a more concerted, coordinated, and effective effort that accelerates the upward trend of state exporting. Connecticut would present a unified team approach to business, rather than a silo-image of services, with one level of government agency involved in one function and another government agency performing another. It would be clearer that all partners, public and private, have a common purpose – improving the expansion of economic opportunities abroad for Connecticut business. This should be achieved without any increase in DECD staffing, if previous business development reorganization recommendations are implemented.

Section II

Tax Credits

The majority of tax credits currently established in statute provide incentives based on the older economic development model (incentives for large companies or for only select industries), whereas in the previous section, the proposed angel investor credit, is a New Economy policy incentive to spur investment in early-stage, innovation-based small businesses. This section reviews the current tax credits Connecticut offers to businesses. Recommendations are made for both repeal and modification of selected credits in order to better align credits with economic development priorities for the New Economy that promote broad-based business incentives.

Tax credits are often used as a policy tool to spur economic activity by lowering the cost of doing business through offsetting taxes owed. As a policy tool, tax credits should be designed according to four relevant principles of taxation: *neutral* – taxes should have as little an effect on market decisions as possible by being broad-based; *fair and equitabl*e – taxes should treat similar taxpayers the same and should be based on ability to pay; *easy and economical to administer* – minimizing cost of compliance for taxpayers and of collection by government; and be *measured to ensure accountability*.[23]

Connecticut business tax credits

The October briefing report provided a description of the major business credits with the highest utilization and the highest total dollar value. In Connecticut, the vast majority of business tax credits can only be used by incorporated businesses that would pay a corporation tax and not by S corporations (e.g., limited liability corporations and partnerships) where taxes are owed on the personal income paid to individuals in the business.

Table II-1 provides a comprehensive list of all business tax credits offered to Connecticut businesses along with cumulative statistics on usage and foregone revenue for the time periods listed. The table also denotes which state agencies are responsible for administration of the credits; some tax credits are administered solely by the Department of Revenue Services (DRS) while other credits require Department of Economic and Community Development (DECD) or Commission on Culture and Tourism (CCT) approval. A few of the tax credits have been repealed and that is noted where applicable.

[23] Brunori, David, "State Tax Policy: A Political Perspective." The Urban Institute Press, 2001.

Table II-1: Connecticut Business Tax Credits (sorted first by agency responsible for administration and second by total funding)					
Tax Credit (year became effective)	**Guidelines**	**Admin.**	**Years**	**Utilization**	**Total Funding/ Amt Approved**
Urban and Industrial Site Reinvestment Tax Credit (July 2000)	• Investments in eligible urban reinvestment projects or eligible industrial site investment projects • Credit equal to 10% of financial investment, beginning three years after investment made • Transferrable	DECD	2000-July 2009	8 companies	$203 million
Film Tax Credits (July 2006)	• Digital animation – production expenses or costs in excess of $50,000; credit equal to 30%; after Jan 1, 2009, credit equal to 50%; after Jan 1, 2012 credit equal to 100% • Film production - production expenses or costs in excess of $50,000; credit equal to 30% • Film production infrastructure – projects requiring capital investments eligible for tax credit of 10-20% • Transferrable	DECD (prior to 2009, CCT)	As of 10/20/09	76 certificates issued	$137.7 million
Enterprise Zones/Urban Jobs (July 1996)	4 programs: • 5-year, 80% abatement on local property taxes • 10-year, 25-50% credit on corporate business tax • Operation of a manufacturing facility qualifies for a 50% corporate business tax credit, or 25% if employment criteria not met • Newly formed corporations meeting employment criteria qualify for a 100% corporate tax credit in first 3 years, and 50% in next 7 years	DECD	2000-2006 (corporate tax credit) 2000-2008 (property tax abatement)	396 credits issued (corporate tax) 623 companies (property taxes)	$6.7 million (corporate tax) $62.5 million (property tax)
Insurance Reinvestment Fund Tax Credit (June 1994)	• Investment in insurance-related businesses made through approved fund managers • Credit value: 10% in years 3 through 6; 20% in years 7 through 9 • Transferrable	DECD	1999-2006 (corporate tax credit) 1999-2007 (insurance premium tax) 2004-2007 (personal income tax)	128 actual jobs created	$3.2 million (corporate tax) $43.2 million (insurance) $5.7 million (personal)
Job Creation Tax Credit (July 2006)	• Businesses creating 10 new jobs • Credit value: up to 60% of income tax deducted and withheld from wages; credits granted for five successive years • Total amount of credits not to exceed $10 million annually	DECD	2006 - Nov 2009	6 companies; 454 proposed job creations	$4.1 million

Table II-1: Connecticut Business Tax Credits (sorted first by agency responsible for administration and second by total funding)					
Tax Credit (year became effective)	**Guidelines**	**Admin.**	**Years**	**Utilization**	**Total Funding/ Amt Approved**
Financial Institutions (January 1995)	• Financial institutions that build and occupy a facility of at least 900,000 square feet and maintain an average of 1,200 to 2,000 employees • Credit value: Years 1-10, 30% to 50% of corporate business tax depending on employment; Years 11-15, 25%	DECD	2000-2006	22 credits	$106,000
Fixed Capital (July 1997)	• Credit value: 5% of amount paid for fixed capital • Carried forward for 5 years	DRS	2000-2006	24,277 credits	$370 million
Electronic Data Processing (June 1994)	• Credit value: 100% of personal property tax owed and paid on electronic data processing equipment • Computers, printers, bundled software, and any computer-based equipment qualifies	DRS	2000-2006	20,114 credits	$143 million (corporate tax) $97.6 million (insurance tax)
Incremental R&D (July 1992)	• Incremental R&D investments • 20% credit	DRS	2000-2006	949 credits	$96.6 million
Non-incremental R&D (July 1993)	• New R&D investments • Credit value: sliding scale based on amount invested; ranges from 1-6%	DRS	2000-2006	1,138 credits	$78.3 million
Housing Program Contribution (June 1987)	• Businesses that make cash contributions to housing programs that benefit low and moderate income individuals and families • Credit value: 100% of contribution not to exceed $500,000 in one year; credits in aggregate not to exceed $10 million	DRS	2000-2006	167 credits	$20.2 million (corporate tax) $7.2 million (insurance tax)
Machinery & Equipment (July 1993)	• Companies with less than 800 employees • Deduct incremental investments in machinery and equipment • Credit value: 5-10% against corporate tax depending on employment size	DRS	2000-2006	2,611 credits	$18.2 million
Human capital (July 1997)	• Job training, donations to higher education, subsidies for child care, contributions to Individual Development Account Reserve Fund • Credit value: 5% for human capital expenditures • Carry forward for five years	DRS	2000-2006	1,456 credits	$14.3 million
Neighborhood Assistance (June 1982)	• Investments in certain community programs • Credit value: 40-100% of cash invested depending on project type	DRS	2000-2006	828	$9.5 million (corporate tax) $0.9 million (insurance tax)
Insurance Department Assessment Credit (1959)	• Certain local domestic insurance companies are allowed a credit against the insurance premiums tax • Credit value: 80% of the Connecticut Insurance Department assessment paid during the calendar year if assets do not exceed certain amount	DRS	2001-2007	96 credits	$7.2 million

Table II-1: Connecticut Business Tax Credits (sorted first by agency responsible for administration and second by total funding)					
Tax Credit (year became effective)	**Guidelines**	**Admin.**	**Years**	**Utilization**	**Total Funding/ Amt Approved**
Apprenticeship training in manufacturing, construction, and plastics-related trades (June 1979)	• Credit value: $4 per hour worked by apprentice; not to exceed $4,800 or 50% of actual wages paid for manufacturing and plastics; $2 per hour and not to exceed $4,000 for construction trades	DRS	2000-2006	174 credits	$3.7 million
Donation of Land (June 1999)	• Credit for donation of open space or land for educational use • Credit value: 50% of fair market value of land • Carry forward of 15 years	DRS	2000-2006	117 credits	$3 million
Employer Assisted Housing (repealed June 2006)	• Tax credits equal to amount contributed into a loan fund that provided housing for low and moderate income employees of the business firm	DRS	2000-2006	29 credits	$512,000
Small Business Guarantee Fee Tax Credit (June 1999)	• For small businesses, gross receipts less than $5 million, that obtain guaranteed financing from federal SBA • Credit value: amount paid as a guaranty fee to the Small Business Administration	DRS	2000-2006	36 credits	$446,000
Hiring Incentive for employing recipients of Temporary Family Assistance (TFA)	• Employee must be recipient of TFA and work a minimum of 30 hours per week • Requires Department of Labor approval • Credit value: $125 for each full month of employment	DRS	2000-2006	50 credits	$358,000
Clean Alternative Fuels (repealed as of Jan 2008)	• Credit value: 10% of expenditures paid for incremental cost of purchasing a clean alternative fuel vehicle; 50% of expenditures for clean alternative fuel equipment	DRS	2000-2006	31 credits	$245,000
R&D grants to Higher Education (July 1992)	• Credit for businesses that make grants to higher education institutions • 25% credit	DRS	2000-2006	6 credits	$239,000
Computer Donation (May 2000)	• Donation of computers less than 2 years old to a local or regional board of education or public or nonpublic school • Credit value: 50% of fair market value; maximum of $75,000 per business	DRS	2000-2006	4 credits	$70,000
Displaced Worker (April 1998)	• Credit of $1,500 per displaced worker hired	DRS	2000-2006	3 credits	$2,500
Historic Homes (Jan 2000)	• Credit value: 30% of rehabilitation expenditures; credit not to exceed $30,000 per unit and $3 million annually for all units	CCT	2000-2006	50 credits	$1.1 million (corporate tax) $7.1 million (insurance tax)
*Insurance Premium Tax data – calendar year 2001 to 2007; Corporate Tax data 2000-2006 Source: PRI staff analysis					

Assessing effectiveness of tax credits

Most states offer business tax credits as part of their economic development strategies. Many also review the tax credits periodically to determine their efficacy and whether they should be continued.

By statute, DECD is required to conduct a study to estimate the state revenue that will be generated by the projects at the time the credit is granted and also continually assess what revenue actually is generated. Based on the information provided in DECD's annual reports, the estimates are calculated at the time of application and approval of projects and republished each year in the annual reports. However, data are not based on actual figures once the project and company has been established in the state, but simply restate the estimates from the application. The figures are merely estimates and do not reflect what the company has actually contributed to the Connecticut economy, and provide no useful information in determining if these tax credits have been effective in spurring economic activity in the state.

As a separate effort, the legislature created a Business Tax Credit and Tax Policy Review Committee in statute in 1997 and reconstituted it in 2005 with the task of annually evaluating changes or modifications made to business tax credits to determine their impact on economic development in the state. The Department of Revenue Services made a presentation to the committee; however, that appears to be the only activity of the committee. In addition, the Legislature's Finance, Revenue, and Bonding Committee also asked the Connecticut Center of Economic Analysis to study corporate tax policy including tax credits and their study was published in December 2005.[24]

PRI staff reviewed the current business tax credits offered and provides recommendations based on the previously sited principles of taxation. Overall, PRI staff recommends the jobs creation tax credit and film tax credit be modified to better align state policy with incentive goals. In an effort to streamline business tax credits and reduce administrative costs both for the state and businesses, several credits are recommended for repeal. In addition, PRI staff recommends current and future tax credits have sunset dates and be reviewed for their economic impact especially for credits that result in large revenue losses for the state.

DRS credits with low utilization. Five tax credit programs administered by DRS have had extremely low utilization; fewer than 50 credits in total were issued over the past seven fiscal years, with four of the programs issuing between zero and two credits in the past three years. The credits with low utilization include: financial institutions credit, computer donation credit, displaced worker credit, research and development grants to higher education, and small business guarantee fee credit. Multiple factors could be causing the low utilization such as: no economic activity in that area, the credits are not worth applying for, or companies do not qualify due to narrowly defined criteria. The low usage indicates they are not broad-based tax credits and not fulfilling the purpose of providing an economic incentive to engage in that activity. Therefore, PRI staff recommends:

[24] William F. Lott and Stan McMillen, "The Economic Impact of Connecticut's Corporate Tax Policy Changes: 1995-2012," Storrs: Connecticut Center fro Economic Analysis, University of Connecticut, December 2005.

The following tax credits be repealed effective January 1, 2011:

- **Financial Institutions;**
- **Computer donation;**
- **Displaced worker;**
- **Research and Development to Higher Education; and**
- **Small Business Guarantee Fee Tax Credit.**

Even though the small business guarantee fee tax credit is the only credit aimed at small business, utilization has been extremely low at 15 credits in the last five years, signaling it is not structured properly. Program review staff proposes a recommendation below to give small businesses tax credit benefits.

Although repealing these tax credits produces minimal savings to the state of $123,000 annually, assuming the usage remains the same as in 2006 (latest data available from DRS), it will reduce the number of credit programs DRS must track and administer. Further it should minimize confusion about credits the state offers by reducing the number and focusing on those that support overall state policy goals to spur economic activity.

Job creation. A primary purpose of any tax credit is to promote economic growth, including job creation. The current unemployment in Connecticut (8.8 percent) and nationally (10 percent)[25] indicate that there is an urgent need to create jobs. Since the mid-1990s, prior to the recession, nationally small businesses have created between 60 and 80 percent of net new employment,[26] yet most of the state's tax credit policy is still designed to incent large businesses.

For example, all the tax credits except the Insurance Reinvestment credit only allow businesses to offset liability on corporate, insurance, or utility company taxes. However, in 2006 (the latest available data from DRS) only 43,275 of the 161,025 businesses in Connecticut, or 27 percent, were incorporated businesses (down from 33 percent in 2002).[27] Thus Connecticut's business tax credits are structured so that they do not apply to a large segment of the state's economy and do not benefit a broad base of businesses. In order to spur greater economic activity, credit eligibility should be expanded by allowing credits on personal income tax to S corporations – LLCs and LLPs.

Legislative concern has been raised about allowing business credits to offset personal income tax liability, but a precedent for this does exist in Connecticut. The Insurance Reinvestment credit provides an individual income tax credit. In addition, many states allow credits for entities other than corporations. Massachusetts and Pennsylvania both permit job creation tax credits for S corporations and other examples of states that have broadened credit eligibility can be found in Table II-2.

[25] Bureau of Labor Statistics, November 2009
[26] Small Business Administration, "The Small Business Economy," 2009, pg 9.
[27] Department of Revenue Services Annual Reports

Connecticut has a job creation credit in place but it has not been widely used (only six credits issued since 2006) and, as presently established, is not a broad-based credit. Even though new firms and small businesses have been responsible for almost all of the net new jobs over the past three decades,[28] the current credit eligibility makes the job creation tax credit suited only for large companies. The requirement that 10 new jobs be added in the state is not realistic job creation for a small company. Further, the current job tax credit is targeted only at incorporated businesses, which is not a large percentage of state businesses. Given the economic situation of the state, the lack of job growth for the past 10 years, and the low usage of the current job creation tax credit, program review staff recommend the job creation tax credit be modified as follows:

> **For the period beginning January 1, 2010, and ending January 1, 2013, companies may take a tax credit for each new full-time job created beyond the 2009 base year of employment. To be eligible for the credit the new job must be filled by a Connecticut resident. The credit will be equal to 15 percent of the wages paid. The business creating the job may claim the credit against its tax liability for the corporate income tax, insurance premiums tax, utility company's tax, or personal income tax. New jobs must pay at least 80 percent of state median income and offer health care benefits. The credit will be issued in three installments over three years. The annual maximum credit per job is $4,000 and the total credit amount is capped at $25 million annually. Businesses must apply to DECD and approval will be on a first-come, first-served basis. Businesses claiming a credit with respect to job creation may not claim a credit against any tax under other provisions of the general statutes for job creation.**

Rationale. Not only is the federal government grappling with policy solutions for the nation's high unemployment levels but individual states have been looking for ideas on how to create jobs as well. As part of New Jersey's Economic Stimulus Act of 2009, the state offered a $3,000 grant for each new job created between December 1, 2008 and January 1, 2011. In the first few months of implementation, almost all of the $70 million allocated for the program was spoken for, indicating jobs were being created, at least to be eligible for the program. It is still too soon to know how many jobs were created as a result of the incentive; New Jersey's unemployment rate is currently 9.3 percent. As with any job creation incentive, it is difficult to know what the unemployment rate would be without the grant or credit and also how many of those jobs might have been created without the credit.

Twenty-two states offer broad state-wide job creation tax credits while 12 states target specific industries or geographic zones, with each state structuring the guidelines and incentives slightly differently.[29] Many of the tax credits were in place prior to the recession. Table II-2 highlights how other states have structured job creation tax credits.

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[28] Dane Stangler and Robert Litan, "Where Will the Jobs Come From," Kauffman Foundation, November 5, 2009.
[29] Federal Reserve Board of San Francisco, "Tax Credits for Job Creation and Retention: What Can We Learn from the States?" Number 2009-08, February 20, 2009.

Table II-2: Selected State Job Creation Tax Credits	
State	**Credit Guidelines**
Colorado	-Qualify for credit based on # of jobs by area; pay wages above local averages -State income tax credit based on payroll tax incurred from new jobs -Must create a new job for one year before become eligible
Massachusetts	-Create 10 full-time equivalent biotechnology and medical device manufacturing jobs -Incentive payment equals 50% of salary attributable to new jobs times personal income tax -Payment made in equal installments over three years
North Carolina	-Create minimum of 5-15 jobs based on county for new full-time jobs -Credit taken over four years following the year the jobs are created -Must offer health insurance and wage must meet or exceed county standard -Offset state income and franchise tax liability; unused credits carried forward for 5 years
Maryland	-Credit for businesses that expand or establish a new facility before January 1, 2013 and create full-time jobs paying 150% of federal minimum wage -Credit may be taken against one of the following: corporate tax, personal income tax, insurance premiums tax, and public service company franchise tax -Credit equal to lesser of $1,500 times number of jobs or 5 percent of wages paid if in revitalization area or $1,000 or 2.5 percent if not in revitalization area -Half of the credit claimed in first year and half in following year
New Mexico	-Credit equal to 10 percent of combined salaries and benefits for each new job -May take the credit for up to 4 years and excess credit will be refunded -Credit shall not exceed $12,000 per year per job -Credit applied against state portion of gross receipts, compensating, and withholding tax
Ohio	-Create at least 25 new full-time positions paying 150% of federal minimum wage; in special circumstances could create 10 new full-time positions if pay 400% -Applied against corporate or income tax and is refundable -Terms of credit determined by tax credit authority
Pennsylvania	-Create at least 25 jobs or increase employment by 20% within three years -Credit value of $1,000 per new job; a minimum of 25% of credits awarded each year will go to employers with 100 or fewer employees -Business must maintain operation in the state for five years -Employees must earn hourly wage rate of at least 150% of federal minimum wage -Claim the credit when job is created
Source: Various states' department of revenue websites	

Moody's Investors Service predicts Connecticut will be one of 31 states that will recover from the recession last – not until third quarter 2010. Therefore, Connecticut must take actions to hasten the state's economic recovery. A wide-ranging and temporary job creation tax credit seems necessary given Connecticut's current conditions and future forecast.

Program review staff estimates that if $25 million is committed annually for the next three years, anywhere from 6,250 jobs to 12,800 jobs could be created over those three years.[30] Expanding the credit to allow businesses other than corporations will allow more small businesses to qualify, and the creation of just one job to be eligible for the credit should also spur employment activity. Although program review staff is recommending expanding the cap placed on the credit from $10 million to $25 million, it is a paltry amount when compared with other credits administered by DECD that have produced far fewer jobs. Additionally, through the

[30] Low estimate using max credit of $4,000 per job annually; high estimate calculated by using 2008 state median income of $48,788 times 80% (which equals $39,030) times the 15% credit for a total credit of $5,855

creation of new jobs, more Connecticut residents will be employed, meaning fewer residents relying on safety nets such as unemployment insurance and Medicaid. The state could also expect some of the foregone revenue to be offset by the income tax paid from the jobs created.

It is important to establish a base-year of employment to safeguard against firms firing and re-hiring to qualify for the credit. Capping the credit at a maximum amount per job ensures the policy does not end up just subsidizing high-wage jobs. On the other hand, having a minimum wage threshold ensures good-paying jobs are created.

The credit will be issued on a first-come, first-served basis depending on the job creation date. The other option would be to take the $25 million and divide it up based on the number of jobs created in the entire year. However, this decreases the value of the credit and is harder to manage. Offering it based on a first-come, first-served basis has several benefits: it encourages businesses to hire now, it makes it easier to administer, and the credit value is certain for those businesses that create jobs quickly.

With numerous reports citing job growth coming from small businesses, and more recently, Moody's predicting that states with high-tech employment are likely to recover faster because that is where job growth will come from, and mostly in small businesses, Connecticut needs to make small business growth a priority. Expanding the jobs creation tax credit to LLCs and LLPs extends the opportunity for small businesses to participate. Having a start and end date to the credit encourages hiring when it is most needed, rather than waiting until the economy improves.

Aligning incentives with state goals. More than 40 states offer tax breaks or rebates for film and television production.[31] States across the country are questioning the longer-term economic benefits that come from such a targeted or specific industry, and one that is typically transient. During this economic downturn, some states, including Connecticut, have taken measures to limit or curtail their film tax credit program. For example, during the 2009 session, the Connecticut legislature eliminated credits for out-of-state expenditures, established the tiered production credit, required half of principal photography days or post-production costs be spent in Connecticut, capped aggregate amounts spent on star talent, and increased the minimum expenditures needed to qualify for the credits.

At the briefing meeting in October, committee members asked for additional information about Connecticut's Film Tax Credits, specifically which ones were targeted at temporary establishments or activity as opposed to permanent infrastructure. Staff obtained the usage of the tax credits broken out by the three types of credits offered. Table II-3 shows the breakout with 98 percent of credits defraying production expenses and only 3 percent for infrastructure projects.

[31] P.J. Huffstutter and Richard Verrier, "Filmmaking Incentives Losing Glamour in Cash-Strapped States," *Los Angeles Times,* September 22, 2009.

Table II-3: Authorized Film Tax Credits, as of 10/20/09		
Tax Credit Type	**Tax Credit amount**	**% of Total**
Film Infrastructure	$3,588,198	3%
Digital Animation	$10, 688,191	8%
Film Production	$123,440,616	90%
Total	**$137,717,005**	
Totals do not add up to 100% due to rounding; Does not include most recent South Windsor project Source: Commission on Culture and Tourism		

Program review staff finds that the film tax credits are structured such that they provide greater incentives for temporary production and not more permanent activity. If the companies make more permanent capital investments they qualify only for a 10 to 20 percent credit, whereas production expenses qualify for a 30 percent credit. To correct this, program review staff recommends:

The film tax credit be modified such that capital investments qualify for a 30 percent credit and production expenses qualify for a 10 to 20 percent credit.

By changing the incentives, Connecticut would be promoting more permanent film production establishments rather than temporary productions. Although this tax credit targets an industry that has traditionally not been one of Connecticut's economic strengths, as the newer model of investment strategy suggests, PRI staff believe the credit should be allowed additional time to demonstrate an impact before evaluating its value to the state's economy. An initial evaluation of its effectiveness was conducted by DECD in 2008. While only one year of data was available for the review, the results of the analysis indicated that the tax credit has a small and positive impact on the state's economy. [32] However, the findings are sensitive to the assumptions used in the analysis and one year may not be indicative of a trend. Based on statutory guidelines, DECD is slated to conduct another review in 2010 allowing for a more robust assessment of the credit since businesses will have had more time to respond to the incentives. Also, ending the credit after a short amount of time would send a signal to the business community that Connecticut's incentives are unpredictable; however committee staff conclude that modifications are necessary in order to align the credit with state priorities. These changes still provide credits for all types of film activity but incent more permanent business activity which will have a longer term impact on the state economy.

Economic impact. As previously mentioned, DECD is required to provide an analysis of the economic impact of all credits requiring their approval. However, the analysis provided in the annual report is based on predictions made upon approval of the credits and is never updated to reflect the impact of actual investments made by businesses. Many of the credits authorized by DECD result in large amounts of foregone revenue to the state and not understanding the actual,

[32] DECD, "The Economic and Fiscal Impacts of Connecticut's Film Tax Credit," February 2008.

as opposed to potential, impact on the Connecticut economy represents a significant lack of oversight. Given the fiscal value of the credits approved by DECD and the limited number of companies awarded credits to date, program review staff recommends that:

Tax credit programs in which either 1,000 or more credits a year are allowed or the credit value exceeds $5 million annually be reviewed by January 1, 2012, to determine the economic impact and be subject to extension or modification by the General Assembly for another five years based on results of the study.

Currently the Film Tax Credits and Enterprise Zone credits require an analysis on their impact to the state. DECD issued the first report in February 2008 on the film tax credits and statute requires a report to be produced every two years.[33] The Enterprise Zone Credits are also subject to review by January 2011.

However, Connecticut is unique in that it does not establish end dates to its tax credits. In review of tax credits offered across the country, majority of the credits reviewed have an established end date. This sets a time frame up-front and allows businesses to plan based on the criteria set forth initially, instead of wondering if at any point in time the credits will be revoked. Therefore, PRI recommends,

Newly established tax credits shall include a review date to determine their effectiveness and the credit will be repealed, modified, or continued based on results of the review.

One credit of particular concern is the Insurance Reinvestment Tax Credit. The tax credit, by legislation, has not been subject to review and the economic benefit of the credit to the state is uncertain. In order to qualify for the credit, investors do not need to prove that the economic activity will result in a net gain for the state. As such, the credit has produced little job growth and at a high cost to the state. In total, $52 million in corporate, insurance premium, and individual income tax credits have been awarded, with 128 jobs created over nine years, at an average cost of $406,250 per job. Between 2004 and 2007, fewer than 10 individual income tax payers each year received credits totaling $5.7 million over the four-year period, meaning state taxpayers have lost a great amount of revenue to a few individuals with high tax liability. In summary, the tax credit is not broad-based, is not fair and equitable, and the benefit to the state's economy is questionable.

DECD has proposed legislation to repeal this tax credit but the legislation did not pass. Instead, modifications were made to the credit that will make investments made in an insurance business after December 31, 2015, not eligible for the credit. However, given the economic situation of the state and the credit's poor track record in job creation and cost, action should be taken sooner on ending the credit. Therefore, PRI staff recommends,

The Insurance Reinvestment Tax Credit be terminated effective January 1, 2011.

[33] Sec. 10-417

If the amount of credits issued maintain the same level as the most recent year reported, repealing the tax credit could save the state approximately $14 million next year. This money instead could be used for the proposed job creation tax credit recommended earlier, which has the potential to have a greater impact on improving the job conditions in the state than the Insurance Reinvestment Tax Credit.

Standard threshold for credits. At the October briefing, committee members asked if there is a standard cost-effectiveness threshold that states should spend per credit per job created. There is not a published standard for states; however, the federal government regulations for the Community Development Block Grant administered by the Housing and Urban Development set a cap at $35,000 per permanent full-time equivalent job retained or created.[34] In addition, the Connecticut Development Authority's underwriting guidelines provides assistance up to $20,000 per job created. As noted in a recent New England Public Policy Center paper on tax credits, a threshold may not be the best measurement but instead the cost-effectiveness should be compared to policies aiming to achieve similar goals.

[34] Weiner, Jennifer, "State Business Tax Incentives: Examining Evidence of their Effectiveness," New England Public Policy Center, December 2009.

Section III

In addition to the broader study concerning aspects of Connecticut's economic competitiveness, examined in earlier sections, the study scope also called for a narrower look at Connecticut's economic competitive position with its border states. This section focuses on Connecticut's alcohol sales policies compared with the surrounding border states of New York, Massachusetts, and Rhode Island.

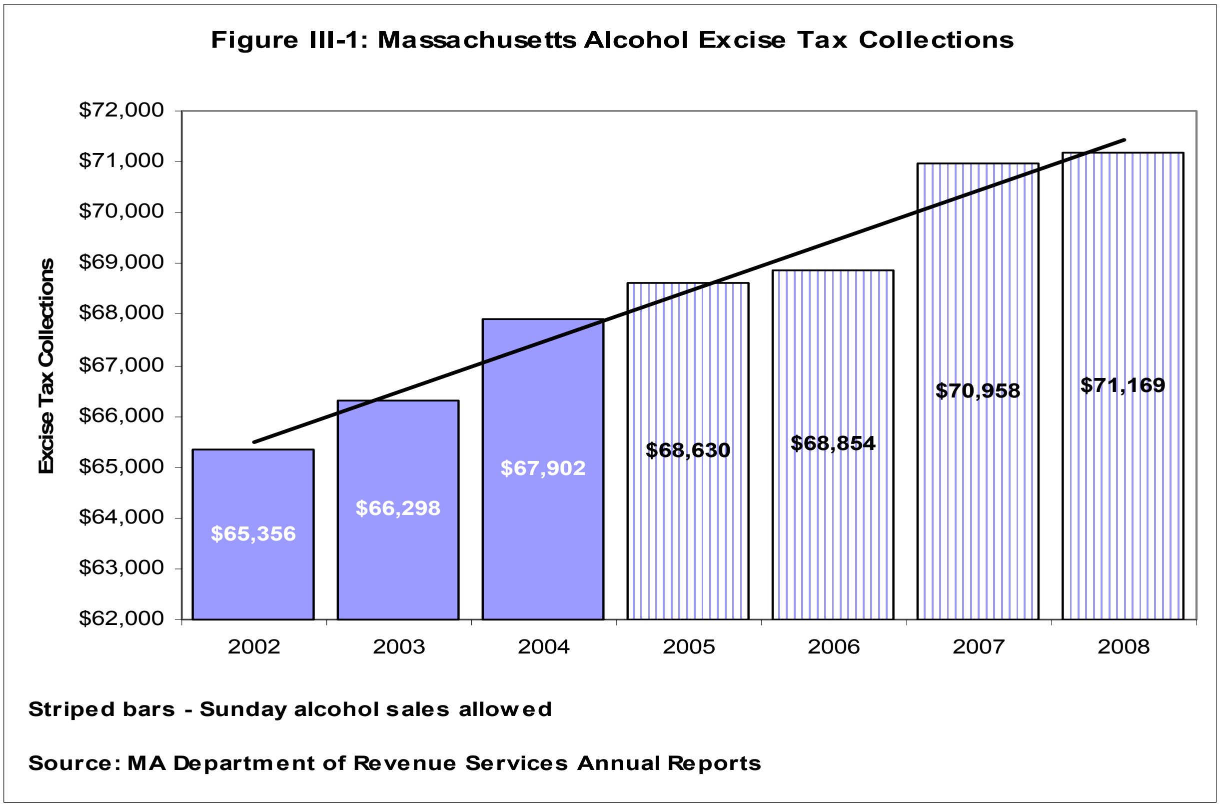
Sunday Sales

Allowing Sunday sales of alcohol has been a policy states have debated for many years. Since 2002, 13 states, including Massachusetts, Rhode Island, and New York, have changed their laws repealing Sunday sales bans. Now only 14 states have a ban, with Connecticut the only New England state continuing to prohibit the sale of alcohol on Sunday.

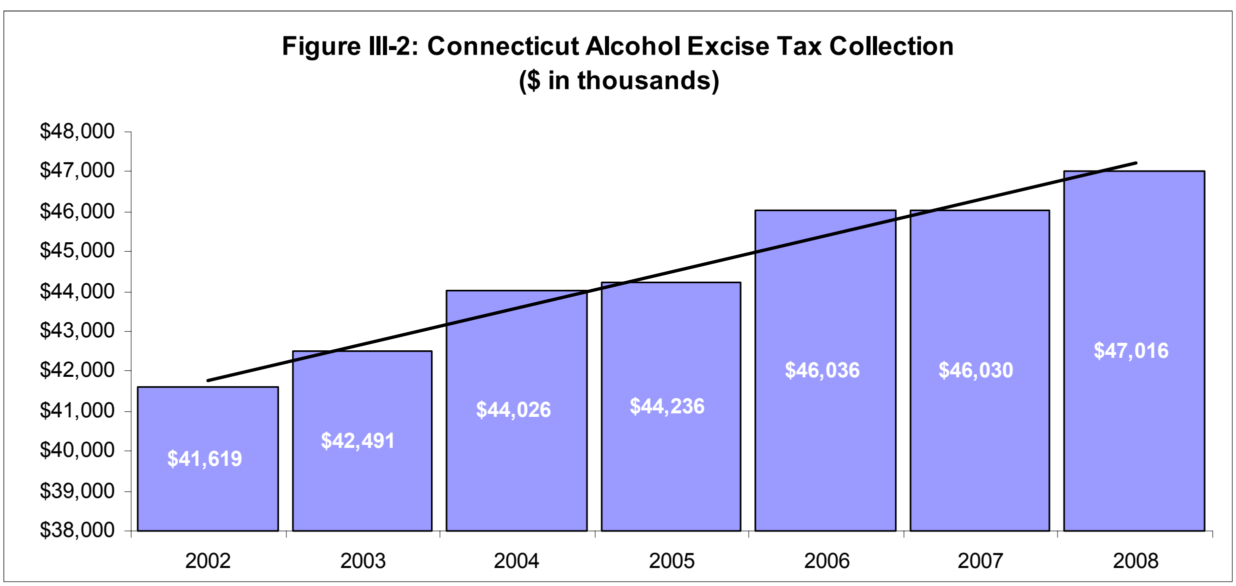
In the briefing report, program review staff examined the impact allowing Sunday alcohol sales had on Massachusetts excise tax collection. Excise taxes[35] as opposed to sales tax[36] data were used to determine if increased sales occurred, because the excise tax was continuous during the time period analyzed while up until August 2009, Massachusetts did not charge sales tax on alcohol.

Figure III-1 was presented in the briefing report and depicts Massachusetts' excise tax collections prior to and after allowing Sunday alcohol sales, which occurred in January 2004. One might expect a larger than normal increase in revenue in 2004 when Sunday sales began and then a leveling off as consumers adjusted to the change. However, as depicted in the figure, allowing Sunday sales had little impact on excise tax collections. Prior to allowing Sunday sales, excise tax collections were increasing and continued to increase at a steady rate after the law changed with a large increase occurring between 2006 and 2007, two years after the Sunday sales ban was lifted.

[35] Excise taxes are selected sales taxes, applied to specific consumer products, and typically levied in addition to the sales tax. Alcoholic beverages, tobacco products, and motor fuel are the most common consumer products that have excise taxes.
[36] Sales tax is imposed on tangible personal property



After the briefing, PRI staff analyzed excise tax collections for the same time period in Connecticut with the data presented in Figure III-2 below. Over the period, overall excise taxes from alcohol sales rose 13 percent, greater than the increase in Massachusetts (9 percent), even though the ban on Sunday sales was lifted in Massachusetts during this time period, and remained in place in Connecticut.



However, the briefing analysis did not address location of alcohol sales in Massachusetts. Upon review of recent literature, it appears that location of sales (i.e., where alcohol is allowed to be sold) prior to lifting a Sunday alcohol sales ban impacts sales once the ban is lifted. A recently released study by Stehr explored the effects of Sunday sales bans on taxes and cross-border shopping.[37] In states with the least restrictions on where alcohol is sold (e.g. grocery stores versus liquor stores), sales improved only marginally, while those that had the most restrictive location requirements, sales increased the most after a ban was lifted.

The study showed that in general, repealing a Sunday ban on spirits (hard liquor only) will increase sales by 3.5 percent but the increase in beer sales was only marginally significant at 2.4 percent. However, in states that did not allow spirits to be sold in grocery stores and then repealed the statewide ban on Sunday sale of spirits, the sales of spirits increased by 7.2 percent. In states that already allowed spirits to be sold in grocery stores prior to the repeal of a Sunday sales ban, there was no significant effect.

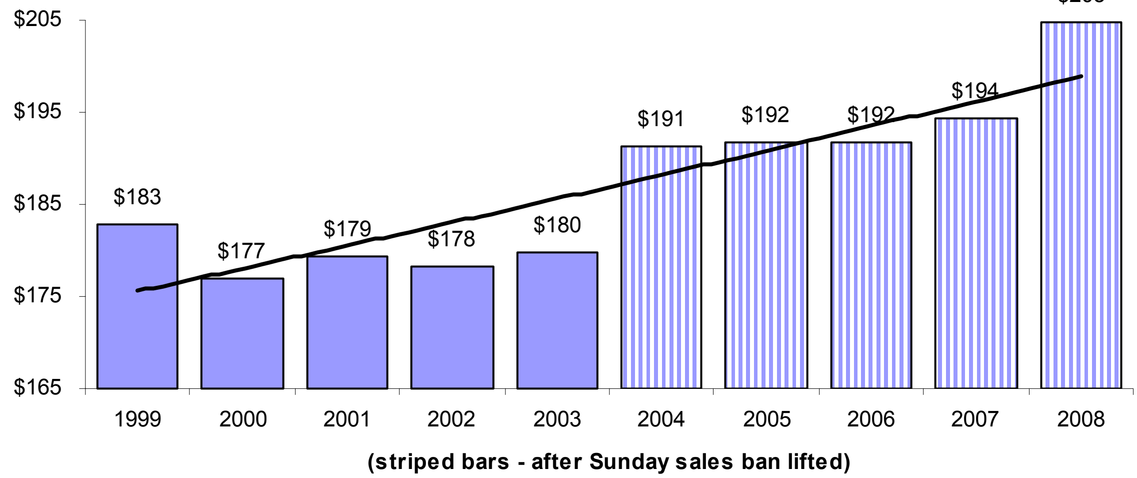
The study looked at the different effects of repealing the Sunday ban, depending on the location of sale of alcohol types and, in particular, whether spirits were sold in grocery stores. The study did not calculate the effect of selling beer and wine in grocery stores, however, it could be the combination of selling beer and wine in grocery stores prior to a Sunday ban, as was the case in Massachusetts, does not greatly affect sales after the ban is lifted. In addition, prior to lifting the Sunday ban, Massachusetts allowed Sunday sales during the holiday season, between Thanksgiving and New Year's Day, and since 1990, also allows stores within 10 miles of the New Hampshire and Vermont borders to be open on Sundays year round. All of these factors could have dampened the effect the repeal of the ban on Sunday alcohol sales had on tax revenue in Massachusetts.

Other state comparison. Due to the additional factors that may have contributed to the unique situation in Massachusetts, PRI staff analyzed several other states' experiences pre- and post Sunday sales repeals and the results are discussed below. New York, Colorado, and Kansas allow only the sale of beer in grocery stores, similar to Connecticut. All three states now allow the sale of alcohol on Sunday, although certain counties in Kansas – about 25 percent - do not allow Sunday sales. In terms of border competition, Kansas stores compete for customers along the Missouri border, a highly populous area of the state, while Colorado does not experience competition from its bordering states.

New York. Figure III-3 presents the overall excise tax collections for New York between 1999 and 2008. When New York repealed the Sunday ban on alcohol sales in 2003, overall excise tax collections increased 6.5 percent in the initial year and then leveled off at about 1 percent per year thereafter until 2008.

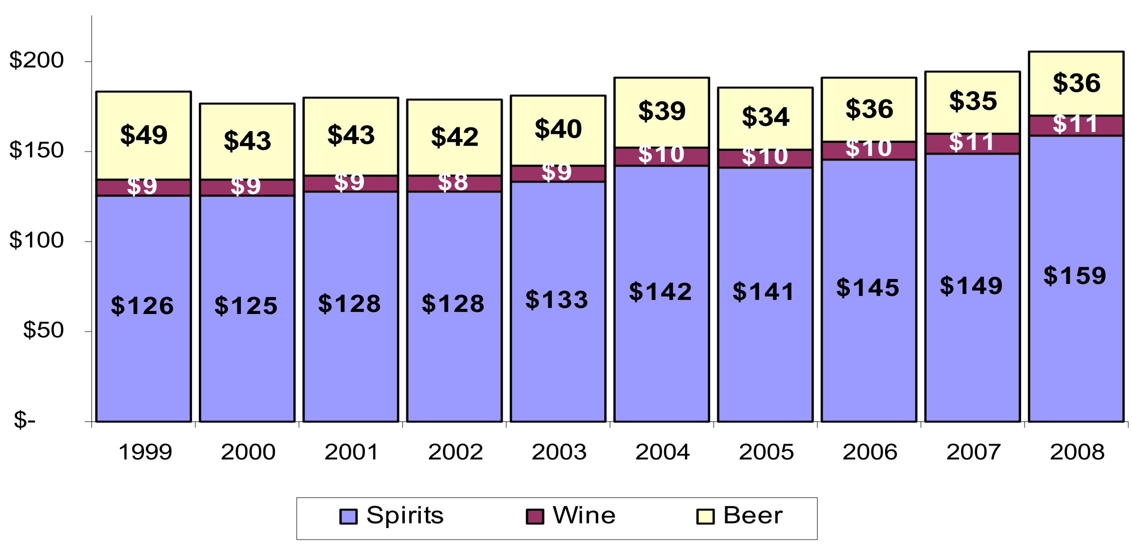
[37] Stehr, Michael, "Excise Taxes on Drinking and Cross-Border Shipping for Alcoholic Beverages," National Tax Journal, March 2007.

Figure III-3: New York Excise Tax Collection: Alcoholic Beverages ($ in millions)



However, the increase in excise tax revenue was comprised of increases in spirit and wine sales only; beer sales actually decreased in the years subsequent to allowing Sunday sales (see Figure III-4). Also of note is the 5 percent increase in excise tax collections from 2007 to 2008, four years after the repeal of the Sunday ban, and the three percent decrease between 1999 and 2000.

Figure III-4: New York Excise Tax Collections ($ in millions)



In the period analyzed, beer sales have been steadily declining while spirit sales have been increasing with notable increases in 2004 and 2008 respectively. Both the increases and decreases suggest alcohol sales are influenced by factors other than repeal of Sunday bans, such as economic conditions.

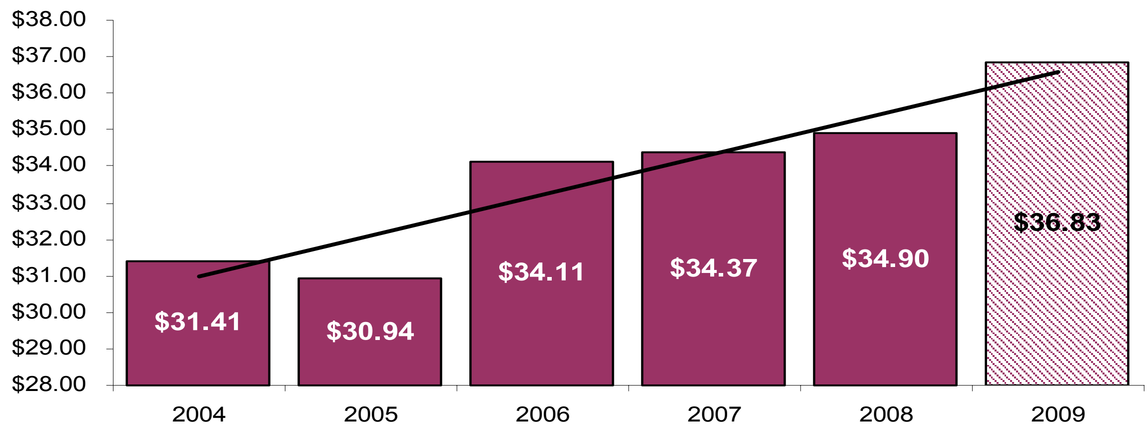
Colorado. In July 2008, Colorado lifted its Sunday alcohol sale ban. In the 12 months after the ban, alcohol sales volume increased most notably in liquor and wine. However, as Table III-1 shows, gallons of all types of alcohol sold in Colorado also increased between July 2005 and July 2006 when compared to the previous 12 months, and the annual percentage increase was even greater than when Sunday sales were allowed.

Table III-1: Colorado Alcohol Sales Volume in Gallons, 12-month increments						
	Liquor	**% change from previous 12 months**	**Wine**	**% change from previous 12 months**	**Beer**	**% change from previous 12 months**
July 2004 – June 2005	8,336,845		11,667,272		105,891,845	
July 2005 - June 2006	9,432,347	13%	12,873,379	10%	110,269,523	4%
July 2006 – June 2007	9,496,025	1%	13,753,428	7%	109,112,723	(1%)
July 2007 – June 2008	9,638,434	1%	13,881,431	1%	110,755,376	2%
July 2008 – June 2009	10,276,930	7%	14,793,954	7%	114,367,629	3%
Quarter	**Liquor**	**% change**	**Wine**	**% change**	**Beer**	**% change**
July 2008 – Sept 2008	2,788,163		3,937,343		33,744,668	
July 2009 – Sept 2009	2,487,779	(11%)	3,536,224	(10%)	30,478,765	(10%)
Source: Colorado Department of Revenue Services						

However, this increase in 2008 and 2009 may not be sustained. In comparing the most recent three months of sales in Colorado (July 2009 – September 2009) to the same quarter in 2008 (July 2008 – September 2008), gallons sold for all three beverage types are down 10-11 percent. It is difficult to predict a trend from only one calendar quarter of sales data, but it suggests that an initial increase in sales occurred immediately following the passage of Sunday sales and then is being followed by a leveling off or even a decrease in sales. However, this trend could also be indicative of the economic recession as well.

As shown in Figure III-5, Colorado also saw an overall increase of 6 percent in excise tax collections the year after the state lifted the Sunday sales ban. The largest increases came from wine and spirits, 7 percent and 6 percent respectively, with beer tax collections increasing only 3 percent. However, sales increased by 10 percent between 2004 and 2006 when Sunday sales were not allowed. This suggests other factors contribute to increased sales, such as during good economic times people spend money more freely on alcohol, and cut back during recessions.

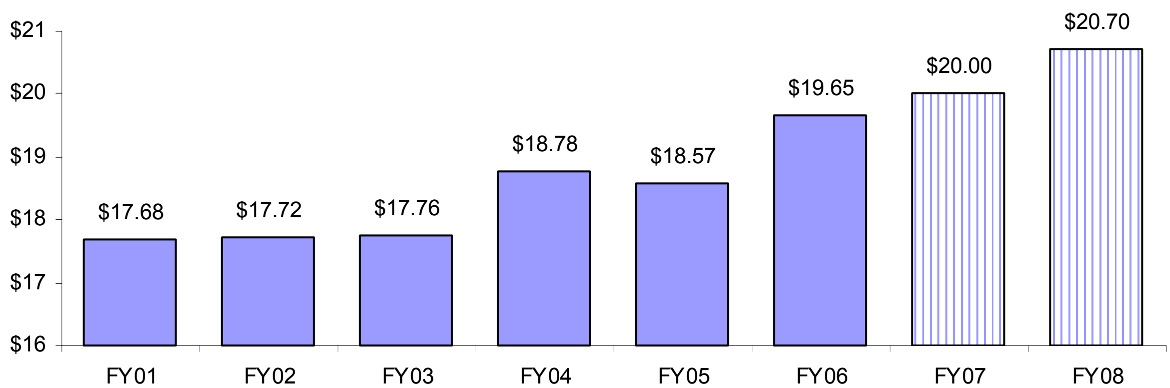
Figure III-5: Colorado Excise Tax Collections: Alcoholic Beverages ($ in millions)



Striped bars - after Sunday sales ban lifted
Source: Colorado Department of Revenue

Kansas. The experience in Kansas also makes it difficult to predict a definite pattern following permitting Sunday alcohol sales. The state legislature allowed counties to open on Sunday in November 2005, halfway through fiscal year 2006. Between 2005 and 2006 sales increased 5.8 percent but in the first full year of allowing Sunday sales, the increase was only 1.8 percent, as shown in Figure III-6.

Figure III-6: Kansas Alcohol Excise Tax Collections ($ in millions)



Striped bars - after Sunday sales ban lifted
Source: Kansas Department of Revenue

These findings suggest that there is typically a bump in sales following the repeal of Sunday sales ban but the percentages of increase vary. The experience in the states analyzed indicates there are other factors, such as the economy, influencing the sale of alcohol and contributing to increases and decreases.

Since all three states examined have experienced a bump in excise tax collections after lifting a Sunday ban, PRI staff calculated a potential increase for Connecticut in the initial year after repealing the ban. The high and low increases for volume of alcohol sold in New York and Colorado were used to calculate a range. (Kansas volume data was unavailable. PRI staff also tried to obtain data from Rhode Island but that state was unable to fulfill the request).

The figures for New York and Colorado in Table III-2, show increases between 7-11 percent for wine and between 7-8 percent for spirits. Beer sales in both states were not impacted by the repeal of Sunday sales ban. In fact in New York, excise tax collections for beer decreased the two years following the ban and in Colorado the 3 percent increase was not substantially different than the average two percent increase in the years prior to the Sunday sales ban.

Using those ranges, Connecticut could anticipate an additional $2.5 - $3.1 million annually in excise tax revenues from the sale of wine and spirits if Sunday sales were allowed.[38] Increases in the amount of alcohol sold would also raise more sales tax revenue. In the year following the repeal of the ban, program review staff estimates that Connecticut could expect an approximate increase of $5 million in sales tax revenue from beer, wine and liquor store sales, for a total revenue gain of $7-8 million.[39]

Table III-2: Volume Increases After Sunday Sales Ban Lifted

	% increase in volume	
State	**Wine**	**Spirits**
New York	11%	8%
Colorado	7%	7%

Source: PRI data analysis

Cross-Border Shopping

As part of the narrower scope, PRI staff also reviewed Department of Revenue Services' (DRS) sales tax data to examine whether there is evidence of Connecticut shoppers crossing the border into Massachusetts to shop.

The Connecticut Department of Revenue Services collects sales tax receipts directly from retailers. However, for retailers with multiple locations in the state, many compile all their store data and submit sales tax collections originating from one retail location to DRS. This means that for large chain-store retailers, they will often report the total of their Connecticut sales from one store. Due to this method of reporting, PRI staff was unable to analyze overall sales tax receipt collections by Connecticut town, thereby making it impossible to analyze cross-border shopping generally.

[38] Calculation based on the percent increases in wine and spirits sold in Colorado and New York multiplied by the 2008 gallons sold in Connecticut multiplied by Connecticut's excise tax rates.
[39] Calculation based on 2008 sales at beer, wine, and liquor stores, assuming an 8 percent increase in sales and a sales tax rate of 6 percent.

However, PRI staff was able to review alcohol sales data from stand-alone beer, wine, and liquor stores (i.e., not grocery stores) in Connecticut. Since legislative permitting laws limit the number of "package" stores one person can own, reporting problems do not arise for these particular retail outlets. The Department of Revenue Services grouped the alcohol sales data by location of the town to the state's borders for years 2004 through 2008. For confidentiality reasons, DRS does not release sales data if there are fewer than 10 retailers in the town, which is why the data are grouped together by town category in Table III-4.

PRI staff assumes that an incentive existed for Connecticut residents to cross the Massachusetts border to shop -- prior to August 1, 2009 -- based on the lower sales tax rate, lower excise tax rates, and also the fact that no sales tax was imposed on alcoholic beverages prior to that date. PRI staff also assumes that New York residents have the opposite incentive -- to cross the border and shop in Connecticut due to a lower sales tax rate in Connecticut. However, with Sunday being the second busiest shopping day and package stores not open on Sunday in Connecticut, fewer New York residents may cross the border to shop. As for the Rhode Island border, little incentive exists for Connecticut residents to cross-border shop because of the higher sales tax, as shown in Table III-3. Due to lower population levels in the Rhode Island and Connecticut towns on the Rhode Island/Connecticut border, PRI staff believes the small variation in sales tax has minimal impact on overall sales tax collections in the state.

Table III-3: Bordering State Sales Tax Rates as of August 2009			
State	**State Tax Rate**	**Local Tax Rate**	**Total Sales Tax**
Connecticut	6%	-	6%
Massachusetts	6.25%	-	6.25%
New York	4%	4.125-4.375%	8.125 – 8.375%
Rhode Island	7%	-	7%
Source: Tax Foundation			

PRI first analyzed the per capita alcohol sales data by town category. Table III-4 shows the per capita (residents over the age of 21) alcohol sales at Connecticut beer, wine and liquor stores (this data excludes beer sales occurring at grocery stores). Based on the per capita sales data, towns that border Massachusetts have lower sales than the other town groupings in the state. In fact, sales in towns bordering Massachusetts are anywhere from 35 percent to 43 percent lower than alcohol sales in Connecticut non-border towns.

Table III-4: Beer, Wine, and Liquor Store Per-Capita Sales in Connecticut Towns by Border, 2004-2008					
	2004	**2005**	**2006**	**2007**	**2008**
MA Border Towns	$197	$213	$234	$249	$271
NY Border Towns	$372	$381	$384	$392	$406
RI Border Towns	$295	$289	$306	$322	$312
Non-Border Towns	$340	$357	$375	$402	$417
Total for CT	$333	$349	$365	$390	$404
Source: Sales data – DRS; Town Population – State Data Center					

Multiple factors could be influencing the sale of alcohol, including price, availability, and income of the consumer. As incomes rise, consumers might either purchase more alcohol or buy higher-priced alcohol, resulting in higher sales and tax collections. However, when considering the average median household income for each of the town groupings, as shown in Table III-5, Connecticut towns on the Massachusetts border household median income is only 11 percent lower than non-border towns while Rhode Island border towns are 19 percent lower. However, Rhode Island towns have a higher per-capita consumption of alcohol than Massachusetts border towns, suggesting factors other than income are influencing lower sales in the latter group. In addition, although New York border towns have a high median household income, per-capita sales are lower than in the non-border towns. However, sales on the New York border are still higher than Rhode Island and Massachusetts border towns. It is difficult to separate the different factors influencing sales but it appears more than just income is driving the differences.

Table III-5: Average Median Household Income by town grouping, 2008	
MA Border Towns	$71,741
NY Border Towns	$108,658
RI Border Towns	$64,480
Non-Border Towns	$79,446
Total for CT	$80,178
Source: CERC Town Profiles	

The study previously cited by Stehr examined the impact cross-border shopping has on state alcohol sales. However, the data were from 2001, and in the analysis, the impact of cross-border shopping to individual states was based on the assumption that no other state had repealed its Sunday sales ban. Since all the states that border Connecticut now allow Sunday sales, that study does not provide a fruitful estimation of the impact cross-border shopping has in Connecticut.

Based on the income and alcohol sales data for Connecticut, further analysis is needed to fully explain the reasons contributing to the lower sales per capita in towns along the Massachusetts border. However, looking at just the sales data from beer, wine, and liquor stores, it appears package stores bordering Massachusetts are losing sales. This may be due to a variety of factors: price; increased availability of where alcohol is sold in Massachusetts; the greater accessibility of the extra day (Sunday) to purchase alcohol; or the fact that until recently Massachusetts had no sales tax on alcohol.

For a variety of reasons, program review staff believes that the Sunday sales ban in Connecticut should be repealed. Therefore PRI staff recommends,

Connecticut liquor and grocery stores should be permitted, but not required, to sell alcohol on Sunday under their current licensing provisions.

Rationale. Sunday sales ban of alcohol is a policy that has been repealed in 36 states. All states in the Northeast have repealed it, considering it to be anti-competitive and limiting consumer preferences.

In Connecticut's case, since the state is small, with cross-border alcohol availability on Sunday appearing to impact sales along the Massachusetts border, the repeal of the ban may lessen the accompanying revenue loss to the state. In fact, if all stores decide to open on Sunday, this recommendation should result in increased revenue to the state of $7.5 to $8 million in the year immediately following the lift of the ban. Given the economic conditions of the state it seems prudent for the state to allow Sunday alcohol sales and offer package stores on the borders to more effectively compete.